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IN THE

Supreme Court of the United States

October Term, 1954

No. 701

COMMONWEALTH OF PENNSYLVANIA,
Appellant

v.

THE BUDD COMPANY (formerly Edward G. Budd Manufacturing Company),
Appellee

COMMONWEALTH OF PENNSYLVANIA,
Appellant

v.

WESTINGHOUSE ELECTRIC CORPORATION,
Appellee

APPEAL FROM THE SUPREME COURT OF PENNSYLVANIA

JURISDICTIONAL STATEMENT

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JURISDICTIONAL STATEMENT

(a) Opinions Below

The majority opinion of the Supreme Court of Pennsylvania is reported at 379 Pa. 159; 108 A. 2d 563. The dissenting opinion of Mr. Justice Jones is reported at 379 Pa. 173; 108 A. 2d 569. The opinions are appended hereto at pages 50 and 64.

The first opinion in the Westinghouse Electric Corporation case by the Court of Common Pleas of Dauphin County, Pennsylvania (the court of first instance), is reported at 63 Dauphin County Reporter 111, and the opinion overruling the Commonwealth's exceptions is reported at 65 Dauphin County Reporter 60 (Westinghouse Record 262a, 334a). The first opinion of the lower court in The Budd Company case is reported at 63 Dauphin County Reporter 164, and the Commonwealth's exceptions were overruled in an opinion reported at 65 Dauphin County Reporter 75 (Budd Record 173a, 210a).

(b) Grounds for Jurisdiction

(i) This is a suit by the Commonwealth of Pennsylvania as plaintiff against the appellees for corporate net income taxes settled against appellees for the year 1944. The cases arose by appeal to the Court of Common Pleas of Dauphin County by the taxpayers from the various actions of the State taxing officials in refusing to grant the taxpayers a deduction against 1944 net income for 1946 net operating losses. The appeal was taken pursuant to Section 1104 of The Fiscal Code of April 9, 1929, P.L. 343, as amended, 72 P.S. § 1104, which provides that appeals taken thereunder "shall be hearings de novo." The Commonwealth is the plaintiff in such proceedings: *Commonwealth v. Central Railroad Co. of New Jersey*, 358 Pa. 326; 58 A. 2d 173, aff'g. 57 Dauph. 255 (1948). As losing party, the Commonwealth appealed to the Supreme Court of Pennsylvania.

(ii) The first decision of the Supreme Court of Pennsylvania was handed down June 28, 1954. The Commonwealth of Pennsylvania filed a timely petition for reargument, which was entertained by the Supreme Court of Pennsylvania and denied per curiam by judgment entered on November 9, 1954. The Notice of Appeal was filed February 4, 1955, in the Court of Common Pleas of Dauphin County, Pennsylvania.

(iii) The jurisdiction of this Court is invoked under 28 U.S.C. § 1257 (2). The tax in question was

imposed under the 1943 reenactment of the Pennsylvania Corporate Net Income Tax. The Commonwealth contended that it would be unconstitutional under the Equal Protection Clause of the Fourteenth Amendment of the Constitution of the United States to construe the Act of 1943 so as to permit the taxpayers which had already paid an annual excise tax for the privilege of doing business in 1944 to reduce the amount of such tax by deducting a loss incurred in a later year. Both the court of first instance and the Supreme Court of Pennsylvania ruled that the Act of 1943 did allow the carry-back and overruled the Commonwealth's objection that it was repugnant to the Constitution and laws of the United States.

In addition there are other grounds for jurisdiction of this Court which would arise under 28 U.S.C. § 1257 (3).

(iv) In the following cases, State taxes which were upheld by the State courts, were held to be unconstitutional by this Court under the Equal Protection Clause of the Fourteenth Amendment of the Constitution of the United States:

Stewart Dry Goods Co. v. Lewis, 294 U.S. 550, 55 S. Ct. 525, 79 L. Ed. 1054 (1935), rehearing den. 295 U.S. 768, 55 S.Ct. 525, 79 L. Ed. 1709, rev'g. 7 Fed. Supp. 438;

Quaker City Cab Co. v. Pennsylvania, 277 U.S. 389, 48 S. Ct. 553, 72 L. Ed. 927 (1928), rev'g. 287 Pa. 161, 134 A. 440;

Liggett Co. v. Lee, 288 U.S. 517, 55 S. Ct. 481, 77 L. Ed. 929 (1933), rev'g. 104 Fla. 609, 141 S. 153;

Royster Guano Co. v. Virginia, 253 U.S. 412 40 S. Ct. 560, 64 L. Ed. 989 (1920), rev'g. Supreme Court of Virginia;

Colgate v. Harvey, 296 U.S. 404, 56 S. Ct. 252, 80 L. Ed. 299 (1935), rev'g. 107 Vt. 28, 175 A. 352.

These cases are discussed in greater detail infra pp. 20-22.

The Commonwealth of Pennsylvania is the proper party appellant to prosecute these appeals; see discussion infra, pp. 22-24.

(v) The relevant provisions of the 1943 and 1947 reenactments of the Pennsylvania Corporate Net Income Tax Act (Act of May 16, 1935, P.L. 209, as reenacted and amended, 72 P.S. §§ 3420a, et seq.), are printed in the Appendix hereto at p. 43.

(c) Questions Presented

Note:—The Pennsylvania "Corporate Net Income Tax Act" was first enacted for a limited period of two years by the Act of May 16, 1935, P.L. 208. It has been reenacted for additional two-year periods by each subsequent regular session of the Pennsylvania Legislature. The act imposes upon every corporation "A State excise tax" at a specified rate per annum "for the privilege of doing business" in Pennsylvania upon "each dollar of net income" received during the calendar or fiscal year.

1. Is the 1943 reenactment of the Pennsylvania Corporate Net Income Tax Act unconstitutional under the Equal Protection Clause of the Fourteenth Amendment of the Constitution of the United States insofar as it has been construed to permit certain corporations which have paid the tax for the annual privilege of doing business in 1944 to reduce such tax by carrying back and deducting operating losses which occurred in 1946?

2. Does the term "net income as returned to and ascertained by the Federal Government", which is used to define "net income" in the Pennsylvania Corporate Net Income Tax, include a deduction for the carry-back of a net operating loss occurring in a future year and thereafter allowed by the Federal Government?

3. Is the 1947 reenactment of the Corporate Net Income Tax Act unconstitutional under the Due Proc-

ess Clause of the Fourteenth Amendment of the Constitution of the United States to the extent that it expressly prohibited the carry-back of an operating loss incurred in 1946 as a deduction against net income for the year 1944?

4. Is the said 1947 reenactment, as construed by the Pennsylvania Supreme Court, unconstitutional under the Equal Protection Clause of the Fourteenth Amendment of the Constitution of the United States to the extent that it prohibited the carry-back of 1946 losses?

(d) Statement of the Case

This case involves the question of the correct amount of the annual excise tax, known as the Corporate Net Income Tax, payable by the appellees for the privilege of doing business in Pennsylvania for the calendar year 1944.

(i) *Facts*

Both The Budd Company and the Westinghouse Electric Corporation are Pennsylvania corporations which have been engaged in business in Pennsylvania and elsewhere for many years.

In 1944 each corporation had a substantial net income. The Budd Company's tax report for 1944 showed a net income to be allocated of $12,066,500.10; taxable net income after allocation of $9,116,764.57; and tax due of $364,670.58. This tax was paid in full by payments made or credits transferred in April, May and October of 1945. The taxing officers of the Commonwealth thereafter resettled the tax at $285,578.61, the reduction in the tax being due mainly to adjustments for renegotiations and amortization deductions. The parties subsequently agreed that under Commonwealth's theory of the case the 1944 tax of The Budd Company should be settled at $328,200.14 (Budd Record, 170a).

Similarly, the resettlement against Westinghouse for the year 1944 showed net income to be allocated of

$91,387,000.59; taxable net income allocated to Pennsylvania in the amount of $35,526,239.54, and tax in the amount of $1,421,049.58 (Westinghouse Record, 50a). This tax was paid in full on April 13, 1945, and May 10, 1945.

Thus, both corporations exercised in 1944 the privilege of doing business in Pennsylvania, and paid in full in 1945 the tax levied upon them for the privilege of doing business in Pennsylvania for the calendar year 1944, i.e., the Pennsylvania Corporate Net Income Tax. These corporations exercised this privilege, voluntarily paid the tax, and these tax transactions with the Commonwealth for that year were closed.

However, in 1946, both corporations had substantial net operating losses. The loss of The Budd Company was $10,596,365.76 (Budd Record, 70a), and the loss of Westinghouse Corporation was $61,662,071.70 (Westinghouse Record, 29a).

Both corporations sought to carry back to 1944 these 1946 losses, even though the Pennsylvania Tax Act at no time since its original enactment in 1935 contained any express provision for such carry-back of losses. In the case of The Budd Company, the allowance of the carry-back will reduce the tax for the privilege of doing business in Pennsylvania from $328,200.44 to $1,186.22 (Budd Record, 171a). The reduction in the Pennsylvania tax for Westinghouse Corporation will be from $1,421,049.58 to $462,216.70 (Westinghouse Record 47a).

Since its original enactment in 1935, the Pennsylvania Corporate Net Income Tax has always been a temporary tax for a two-year period, being reenacted at

each subsequent biennial session of the Legislature. After the Federal income tax law was amended in 1942 so as to permit the carry-back of losses for Federal income tax purposes, some losses from subsequent years in an undetermined number of cases were permitted to be carried back against earlier income by the taxing officers of Pennsylvania at the administrative level, but no court decision or opinion by the Attorney General ever established the right of any taxpayer to such a carry-back.

In 1947, while reenacting for the sixth time the Corporate Net Income Tax Act, the Legislature amended the act so as to specifically prohibit the taxing officers from allowing the carry-back of losses incurred in 1946 or any subsequent years. This act became law prior to the 1946 tax settlements against The Budd Company and the Westinghouse Corporation. The taxing officers refused to permit the carry-back of the 1946 losses to the year 1944.

In the ensuing litigation, the Court of first instance (Court of Common Pleas of Dauphin County) ruled that the 1943 reenactment of the Corporate Net Income Tax did provide for the deduction of losses carried back from later years, and that such a deduction did not violate uniformity or equal protection; that the amendment of 1947 violated due process because it was retroactive, and violated uniformity and equal protection because the few corporations which had dissolved, merged, consolidated or withdrawn during 1946 had received the benefit of the loss carry-back deduction.

On appeal by the Commonwealth, the Supreme Court of Pennsylvania affirmed the decision of the

Court of Common Pleas of Dauphin County in a decision written by Mr. Justice Bell, concurred in by Mr. Justice Musmanno and Mr. Justice Stearne, concurred in result by Mr. Chief Justice Stern and Mr. Justice Arnold, with a dissenting opinion by Mr. Justice Jones, and with Mr. Justice Chidsey not participating because he had previously held the office of Attorney General of the Commonwealth of Pennsylvania.

(ii) *Manner of Raising Federal Questions*

In the Court of Common Pleas of Dauphin County, the court of first instance, the Commonwealth contended that if the 1943 and 1945 reenactments of the Corporate Net Income Tax Act permitted the reduction in the amount of the annual privilege tax by the carry-back of losses occurring in subsequent years, the Acts were unconstitutional to that extent.

This contention was advanced in the Commonwealth's 6th Request for Conclusions of Law filed in both cases with the Trial Court at the time of argument (Westinghouse Record, 229a, Budd Record, 130a). This Request for Conclusions of law read as follows:

> "6. The alleged practice of the fiscal officers of the Commonwealth, in determining corporate net income tax before the enactment of the said Act of 1947, of allowing deductions for net operating losses against the net income for prior years, resulted in an unconstitutional, discriminatory and void determination of the tax for such prior years. Insofar as the said acts of 1943 and 1945 authorized such alleged practice of the fiscal officers,

said acts were unconstitutional in violation of Article IX, Section 1 and Article III, Section 7 of the Constitution of Pennsylvania and *the Fourteenth Amendment to the Constitution of the United States.*" (Emphasis supplied)

The foregoing request was filed with the Court on March 21, 1951. On September 29, 1952, the Court sustained the contention of the taxpayers in an order and opinion in each case (Westinghouse Record 262a, Budd Record 173a), in which it upheld the constitutionality of the 1943 reenactment under the Uniformity Clause of the Pennsylvania Constitution, but was silent as to the Fourteenth Amendment to the Constitution of the United States.

The Federal constitutional question was again raised by the Commonwealth in its Exceptions to the Order of the Court dated September 29, 1952. Again identical Exceptions were filed in the Westinghouse (Exception No. 7, Record, 314a) and The Budd Company (Exception No. 4, Record, 197a) cases. The Westinghouse Exception read as follows:

"7. The learned Trial Judge erred in failing or refusing to make a complete ruling in respect to Commonwealth's sixth Request for Conclusions of Law, which request was as follows:

" '6. The alleged practice of the fiscal officers of the Commonwealth, in determining corporate net income tax before the enactment of the said Act of 1947, of allowing deductions for net operating losses against the net income for prior years, resulted in an unconstitutional, discriminatory and void determination of the tax for such prior years. Insofar as the said acts of 1943 and

1945 authorized such alleged practice of the fiscal officers, *said acts were unconstitutional in violation of* Article IX, Section 1 and Article III, Section 7 of the Constitution of Pennsylvania and *the Fourteenth Amendment to the Constitution of the United States.*' "

(Emphasis supplied)

These Exceptions were filed October 28, 1952. On June 29, 1953, the Exceptions of the Commonwealth were "severally overruled" (Westinghouse Record, 363a; Budd Record, 214a).

Before the Supreme Court of Pennsylvania, the Commonwealth contended that the 1943 reenactment did not authorize the carry-back of losses from later years, but that if it did, it was in violation of the Uniformity Clause of the Pennsylvania Constitution (Westinghouse Brief, pp. 39-48). Similarly, the Commonwealth argued that the 1947 reenactment did not violate the Uniformity Clause of the Pennsylvania Constitution (Westinghouse Brief, pp. 110-134). With respect to the Equal Protection Clause of the Constitution of the United States, the Commonwealth's brief stated (p. 132):

> " * * * It is now an accepted principle that in regard to reasonableness of classification the Fourteenth Amendment of the Federal Constitution and the Uniformity Clause of the Pennsylvania Constitution 'stand in pari materia': Commonwealth v. Firemen's Fund Ins. Co., 369 Pa. 565 (1952)."

The Majority Opinion of the Supreme Court of Pennsylvania expressly rejected the Commonwealth's

contention that the reenactment of 1943, as interpreted so as to permit the carry-back of losses, violated the Uniformity Clause of the Pennsylvania Constitution: 379 Pa. 173; 108 A. 2d 569.[1]

Although the Majority Opinion did not discuss the Federal Constitution on this particular point, elsewhere the Majority Opinion ruled that "* * * the Uniformity Clause of the Pennsylvania Constitution and the Fourteenth Amendment of the Federal Constitution * * *—so far as reasonableness of classification is concerned, or as applied to questions of taxation—stand in pari materia": 379 Pa. 167; 108 A. 2d 566.[2] Such a ruling plainly indicates that the Supreme Court of Pennsylvania in effect was also declaring the reenactment of 1943 constitutional under the Equal Protection Clause of the Fourteenth Amendment to the Federal Constitution.

The Commonwealth again raised this Federal Constitutional question in its Petition for Reargument filed with the Supreme Court of Pennsylvania, wherein it was averred:[3]

> "6. The Majority Opinion (p. 5) incorrectly concluded that, under its interpretation of the reenactments of 1943 and 1945, the Uniformity Clause of the Constitution of Pennsylvania would not be violated. On the contrary, since the Pennsylvania tax is an excise tax for an annual privilege, the charge for the privilege would be different for those corporations which in subsequent years had losses which bore no relation to the

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[1] Appendix, p. 63.
[2] Appendix, p. 57.
[3] Appendix, p. 80.

income for the year for which the privilege is taxed. As to the Westinghouse Corporation, the reduction of tax resulting from the Majority Opinion, when compared with the tax base (each dollar of net income received during the calendar year) reduces the tax rate from 4% to 1.3%. In the case of The Budd Company, the result will be to reduce the rate of tax from 4% to 144/10,000 of 1%. Such a disparity between 4% and 1.3% and .0144% illustrates how *the interpretation of the reenactments of* 1943 *and* 1945 *by the Majority Opinion violates* Article IX, Section 1 of the Constitution of Pennsylvania and *the Equal Protection Clause of the Fourteenth Amendment of the Constitution of the United States.*"

(Emphasis supplied)

The Supreme Court of Pennsylvania denied the Commonwealth's Petition for Reargument, including the foregoing averment, by its Order dated November 9, 1954.

Therefore, from the time of the first argument in these cases before the Trial Court, the Commonwealth has contended that the 1943 reenactment of the Corporate Net Income Tax Act was unconstitutional under the Fourteenth Amendment to the Constitution of the United States to the extent that it permitted a corporate taxpayer to reduce the tax price paid for its 1944 privilege by deducting a loss occurring in a different and subsequent year. Both the Court of first instance and the Supreme Court of Pennsylvania have in effect upheld the constitutionality of the Act of 1943 under the Federal Constitution. This action by the State

Courts gives to this Court jurisdiction by appeal under Section 28 U.S.C. § 1257 (2).

The Commonwealth has also contended from the inception of the present cases that the Federal Government did not "ascertain" the taxpayers' net income for 1944 when it determined that a net loss had been incurred in 1946 and permitted the taxpayers to carry back such loss as a deduction against the 1944 net income. In concluding that the loss carry-back deduction was "net income returned to and ascertained by the Federal Government" for the tax year in question, the State courts misconstrued the applicable Federal tax laws, and have made a decision in the present cases contrary to such Federal tax laws.

The appeals from the resettlements of the State taxing officers to the Court of Common Pleas of Dauphin County as filed by these taxpayers raised the question of constitutionality of the 1947 reenactment of the Corporate Net Income Tax Act under both the Due Process Clause and the Equal Protection Clause of the Fourteenth Amendment of the Constitution of the United States, insofar as the 1947 reenactment deprived the taxpayers of their alleged right to carry-back and off-set their losses for 1946 against their 1944 income. These constitutional questions were in issue throughout the case. The State courts ruled that the 1947 reenactment, because it was retroactive to the tax year 1944, violated the Due Process Clause of the Fourteenth Amendment of the Federal Constitution on the basis of what the Commonwealth believes to be a mistaken interpretation of the decision of this Court in *Welch v. Henry*, 305 U.S. 134, 59 S.Ct. 121, 83 L. Ed. 87 (1938), rehearing denied 305 U.S. 675, 59 S. Ct. 259, 83 L. Ed. 437.

In holding that the 1947 reenactment violated the Equal Protection Clause of the Fourteenth Amendment of the Federal Constitution, the State Courts were inconsistently construing the Act as being prospective, rather than retroactive, as it had been construed on the due process question. Even under such a prospective construction, the Act should not have been held to have violated the Equal Protection Clause because (a) there could have been a valid classification as between going companies and those which had dissolved, merged, consolidated or withdrawn during 1946 and (b) the number of companies which had received the 1946 carry-back was de minimis, and the amounts of tax involved were inconsequential.

(e) Federal Questions Are Substantial

(i) 1943 *Reenactment of the State Tax Act Unconstitutional as to Carry-Back of Losses.*

The Pennsylvania Corporate Net Income Tax Act provided for the imposition of an annual State excise tax for the privilege of doing business in Pennsylvania, based on the net income as returned to and ascertained by the Federal Government, received during the calendar or fiscal year, without any specific provision for the deduction of an operating loss carried back from a later year. The State courts construed the act as permitting the allowance of such a carry-back loss deduction.

This construction rendered the act unconstitutional as to such a deduction, because the corporations which paid an annual excise tax for the privilege of doing business based upon the amount of net income received during the tax year, would be taxed at different rates and/or amounts, depending upon whether in ensuing years they experienced an operating loss which bore no relation to the privilege exercised during the tax year.

Such a construction violated not only the Uniformity Clause of the Pennsylvania Constitution, but also the Equal Protection Clause of the Fourteenth Amendment of the Constitution of the United States. As the Majority Opinion of the State court stated,[4] the Equal Protection Clause and the Uniformity Clause "stand

[4] Appendix, p. 57.

in pari materia"—"so far as reasonableness of classification is concerned, or as applied to questions of taxation".

Therefore, the effect of the decision of the State courts was to reduce the tax rate paid by Westinghouse from 4% of its net income for 1944 to 1.3%, and to reduce the rate in the case of The Budd Company from 4% of its net income for 1944 to 144/10,000 of 1%. It is patently unconstitutional to so construe a tax that some corporations pay for the annual privilege of doing business in Pennsylvania at 4% of their net income while others pay 1.3% or .0144%.

It must be conceded that the Pennsylvania Corporate Net Income Tax is an excise tax. The imposition section (Section 3) specifically states, that it is an "excise tax" imposed for the privilege of doing business in Pennsylvania during the calendar or fiscal year.

At all stages in the present cases before the State courts, all parties agreed that this was an excise tax. In every case arising between the Commonwealth and its corporate taxpayer wherein the nature of the corporate net income tax has been construed, the Supreme Court of Pennsylvania has always held that the corporate net income tax is an excise tax:

Turco Paint & Varnish Co. v. Kalodner, 320 Pa. 421; 184 A. 37 (1936);

Commonwealth v. Warner Bros. Theatres, Inc., 345 Pa. 270; 27 A. 2d 62 (1942);

Commonwealth v. Bayuk Cigars, Inc., 345 Pa. 348, 28 A. 2d 134 (1942); aff'd. 318 U.S. 746, 63 S.Ct. 991, 87 L. Ed. 1123;

Commonwealth v. Electrolux Corp., 362 Pa. 333; 67 A. 2d 105 (1939);

Commonwealth v. Curtis Publishing Co., 363 Pa. 299; 69 A. 2d 410 (1949), cert. den. 339 U.S. 928, 70 S. Ct. 627, 94 L. Ed. 1349.

Only in cases construing the power of local political subdivisions to impose similar taxes has the State court reached what might be interpreted to be a different conclusion.

The measure for the price of the Pennsylvania privilege of doing business in 1944 was 4% of each dollar of net income received during the calendar year 1944. This is undoubtedly a reasonable basis for excise taxation. However, when the price of the privilege was permitted to be varied by the introduction of losses incurred two years later, as the State Court construed the statutes, a classification resulted which bore no reasonable relation to the annual privilege being exercised and taxed.

In *Colgate v. Harvey*, supra (296 U.S. 404, 423), an exemption for interest received on money loaned within the state from the Vermont Income Tax law was held invalid under the Equal Protection Clause. This Court ruled that classification must rest upon some difference having a fair and substantial relation to the object of the legislation, and then applied the following test:

> "* * * does the statute arbitrarily and without genuine reason impose a burden upon one group of taxpayers from which it exempts another group, both of them occupying substantially the same relation toward the subject mat-

ter of the legislation? '*Mere* difference is not enough * * *.'"

In *Quaker City Cab Co. v. Pennsylvania,* supra, (277 U.S. 389, 400, this Court held that Pennsylvania gross receipts tax on incorporated taxicab companies which was not payable by the taxicabs operated by individuals was in violation of the Equal Protection Clause, saying:

"* * * The equal protection clause does not detract from the right of the State justly to exert its taxing power or prevent it from adjusting its legislation to differences in situation or forbid classification in that connection, 'but it does require that the classification be not arbitrary but based on a real and substantial difference *having a reasonable relation to the subject of the particular legislation.*' Power Co. v. Saunders, 274 U.S. 490, 493. * * *"

(Emphasis supplied)

In *Stewart Dry Goods Co. v. Lewis,* supra (294 U.S. 550), this Court held that the Kentucky adjusted gross sales tax could not be sustained as an excise on the privilege of merchandising, because there was no reasonable relation between the amount of the tax and the value of the privilege so as to justify discrimination between taxpayers.

In *Liggett Co. v. Lee,* supra (288 U.S. 517), a Florida statute which levied a heavier privilege tax per store on the owner whose stores were in different counties than on the owner whose stores were all in the same county was held by this Court to be arbitrary

and void, since there was no "reasonable basis for this classification".

In *Royster Guano Co. v. Virginia*, supra (253 U.S. 412), this Court held that an exemption from the Virginia income tax of income derived from outside the State by local corporations which did no local business was invalid under the Equal Protection Clause.

The Pennsylvania Tax is an annual excise tax. It is levied upon the privilege of doing business in Pennsylvania. It is measured by each dollar of net income received during the tax year. Its rate for the year in question was 4%. There can be no reasonable relation between the losses incurred by these taxpayers in 1946 and the privilege of doing business in 1944 in Pennsylvania, for which the taxpayers voluntarily paid tax at the rate of 4% of their net income for that year. The action of the State courts in reducing the base and/or the rate of such tax for those taxpayers which had 1946 losses was an unreasonable and unconstitutional classification under the Equal Protection Clause.

Under the law of Pennsylvania, the Sovereign Commonwealth has the right to contest the constitutionality of the Act of Assembly which if valid, takes away a source of taxes formerly available. The Commonwealth is the plaintiff in the present case: *Commonwealth v. Central Railroad Co. of New Jersey*, supra (358 Pa. 326). As losing party, it has the right to take an appeal from an adverse decision: 2 Am. Jur. 956, Appeal and Error, Section 174.

The law of Pennsylvania upholds the right of public officers to raise constitutional questions in administering acts of the Legislature. This is particularly

true where the legislation, by granting a deduction, deprives the government of tax revenues.

In *Clearfield Bituminous Coal Co. v. Thomas,* 336 Pa. 572, 584, 585, 9 A. 2d 727 (1939), the county commissioners contended that a statute exempting certain property from taxation violated the Constitution, and the Court so held, saying:

> "The question is also presented to us as to the right of the county commissioners to raise the question of the constitutionality of this statute. *We hold that they do have this right.* In Donnelly's Estate, 113 Pa. Superior Ct. 274, 173 A. 876, it was held that county commissioners may contest the constitutionality of an Act of Assembly which, if valid, takes away from them a source of taxes formerly given to them. It was said in that case, in the opinion of President Judge Trimble of the Orphans' Court of Allegheny County (which opinion was adopted by the Superior Court): 'The right of county commissioners to submit to the courts the constitutionality of the amending act is challenged without merit. Their duties are more than ministerial: Corpus Juris, Vol. 15, p. 456 . . . In Com. v. Mathues, 210 Pa. 372 [59 A. 961], . . . a state treasurer . . . was permitted to raise the question of the constitutionality of an act which required the payment of money from the State Treasury. In Dupuy v. Johns, 261 Pa. 40 [104 A. 565], the right was not denied.' See also Retirement Board v. McGovern, 316 Pa. 161, 174 A. 400."
>
> (Emphasis supplied)

To the same effect see *Commonwealth ex rel. Carson v. Brown,* 7 Dauph. 235, 237 (1904), and *Commonwealth ex rel. Woodruff v. Snyder,* 26 Dauph. 320, 325 (1923), affirmed 279 Pa. 234.

The right of State tax officials to apply to this Court for the review of adverse decisions by State courts on cases involving Federal questions has always been recognized: see *Indiana Department of State Revenue, Gross Income Tax Division, State of Indiana v. Nebeker,* 116 N.E. 2d 104 (1953), cert. granted 348 U.S. 808, 99 L. Ed. 24; 75 S. Ct. 24, aff'd. 348 U.S. 933, 75 S. Ct. 354, 99 L. Ed. 275; *Wilson v. Cook,* 327 U.S. 474, 66 S. Ct. 663, 90 L. Ed. 793 (1945), modifying 208 Ark. 459, 187 S.W. 2d 7.

(ii) *Construction of* 1943 *Reenactment Contrary to Federal Law.*

The State courts construed the 1943 reenactment of the Corporate Net Income Tax Act as providing for the carry-back of losses occurring in subsequent years, even though the act contained no provision for such carry-backs. The reenactment continued the same language used when the act was first adopted in 1935 at a time when no loss carry-back deductions were permitted under the Federal law.

This construction of the Pennsylvania Act was in conflict with the State court's earlier decision in *Commonwealth v. Chambersburg Engineering Co.,* 287 Pa. 54, 134 A. 408 (1926). That case was distinguished because, as stated in the Majority Opinion (379 Pa. 172, 108 A. 2d 569):[5]

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[5] Appendix, p. 62.

> "* * * the tax base there was the net income as *returned* to—not ascertained by—the Federal Government. In the instant case neither the Commonwealth nor either of these defendants could know the net income which was its taxable base for the year 1944 until the Federal Government had finally ascertained taxpayer's 1944 net income after deducting net operating losses incurred in 1946. * * *"
>
> (Emphasis the court's)

The foregoing quotation illustrates how the decision of the State courts construing the reenactment of 1943 was dependent upon an interpretation of how and when the Federal Government "ascertained" appellees' net income. While ordinarily the construction of a statute by the State courts is binding on this Court, this Court should not be bound by the construction placed upon a Federal activity, which is determined and controlled by Federal law.

In *Standard Oil Co. of California v. Johnson*, 316 U.S. 481, 483; 62 S. Ct. 1168, 86 L. Ed. 1611 (1942); rev'g. 19 Cal. 2d 104; 19 P. 2d 329, this court said:

> "* * * If the court's construction of § 10 of the Act had been based purely on local law, this construction would have been conclusive, and we should have to determine whether the statute so construed and applied is repugnant to the federal constitution. But in deciding that post exchanges were not 'the government of the United States or any department thereof,' the court did not rely upon the law of California. On the contrary, it relied upon its determination concerning the re-

> lationship between post exchanges and the government of the United States, a relationship which is controlled by federal law. * * * It was upon a determination of a federal question, therefore that the Supreme Court of California rested its conclusion that, by § 10, sales to post exchanges were not exempted from the tax. Since this determination of a federal question was by a state court, we are not bound by it. We proceed to consider whether it is correct."

See also *Crew-Levick Co. v. Pennsylvania*, 245 U.S. 292, 294, 38 S. Ct. 126; 62 L. Ed. 295 (1917), rev'g. 256 Pa. 508, 100 A. 952, where this Court said:

> "As in other cases of this character, we accept the decision of the state court of last resort, respecting the proper construction of the statute, but are in duty bound to determine the question raised under the Federal Constitution upon our own judgment of the actual operation and effect of the tax, irrespective of the form it bears or how it is characterized by the state courts. * * *"

The Commonwealth contends that the clause "net income returned to and ascertained by the Federal Government" does not include the loss carry-back deduction under the Federal law. Obviously, the appellees could not "return" their 1946 operating losses with their 1944 income tax return to either the State or Federal Government. When the Federal taxing authorities ascertained from returns filed and circumstances existing in 1944 the appellees' net income for Federal tax purposes, the net incomes were then "ascertained" for State tax purposes. The

ascertainment would have included any change for fraud, evasion or error in the returns filed.

The carry-back of operating losses for subsequent years could not be within the scope of the terms "net income returned to and ascertained by the Federal Government." Under the Federal Internal Revenue Code of 1939, refunds of income taxes may arise because of (1) carelessness or mistake on the part of the taxpayer, or (2) from operation of law. On the overstatement of net income due to error, the Federal Government allows interest at 6% from the date of payment; but no interest was allowed on a refund arising from the carry-back of a net operating loss: Section 3771 (a), (b) (2) of the Internal Revenue Code of 1939. As to refund claims based on carry-back of losses, Section 3771 (e) states:

> "If the Commissioner determines that any part of any overpayment is attributable to the inclusion in computing the net operating loss deduction for the taxable year of any part of the net operating loss for a succeeding taxable year * * * no interest shall be allowed or paid with respect to such part of the overpayment for any period before the filing of a claim for credit or refund of such part of the overpayment or the filing of a petition with the Tax Court, whichever is earlier: * * *"

This plain distinction between the two types of refunds shows that a refund arising from a carry-back is not a report of change in net income encompassed within the words "fraud, evasion or error". It also shows that a net operating loss carry-back deduction

is purely tax relief, and in no way reflects true net income computed on an annual basis. It in no way changes the net income figure reported in the original tax year. If it did, interest would be allowed on the refund from the date of overpayment.

The true nature of the Federal carry-back was determined in *Manning, Collector of Internal Revenue v. Seeley Tube & Box Co.*, 338 U.S. 561, 70 S. Ct. 386, 94 L. Ed. 346, where this Court held that a carry-back of a loss which wiped out tax due on a deficiency assessment did not strike down interest which had been paid on that deficiency, saying:

> "We hold that when a deficiency and interest have been validly assessed under any applicable statutory procedure, a subsequent carry-back with an abatement of the deficiency does not abate the interest previously assessed on that deficiency."

The rationale of that decision is that the statutory figure of gross income, net income and deficiency are fixed for any particular year as of the end of that year, and subsequent events cannot change such a determination in the absence of fraud or error, even though tax relief in the nature of a loss carry-back refund is later afforded. The application of the theory there used by this Court to the instant case further supports the contention of the Commonwealth that net income as returned to and ascertained by the Federal Government was fixed as the basis for appellee's corporate net income tax liability as of December 31, 1944, subject only to correction for fraud, evasion or error. The rule announced in the Seeley Tube & Box Company case has been followed in subsequent cases:

Nick v. Dunlap (Unreported) 50-2 USTC 9436 (N.D. Texas 1950) aff'd. per curiam 185 F. 2d 674 (5 Cir. 1950) cert. den. 341 U.S. 926;

Petterson v. Commissioner, 19 T.C. 486 (1952).

In discussing the rule in the Seeley Tube & Box Company case, this Court recently said in *United States v. Koppers Co., Inc.,* 348 U.S. 254, 75 S. Ct. 268, 276, 99 L. Ed. 231, 239 (1955):

> "* * * There the Court upheld the collection of interest on a deficiency which later was extinguished by carrying back a loss which occurred in a subsequent year. *It treated the carry-back as a current adjustment of the tax previously determined, characterizing it as an 'abatement'* at 565 * * *"
>
> (Emphasis supplied)

Thus, the carry-back of losses was an "abatement" of taxes, not a reduction of net income as returned to and ascertained by the Federal Government.

See also *Hastings & Co., Inc. v. Smith,* 122 F. Supp. 604, 608 (D.C.E.D. Pa. 1954), where the court said:

> "* * * On the other hand, in the case of the application of the carry-back provisions, the tax extinguished by its application in nowise affects the tax liability of the taxpayer at the time the original tax was due and payable and it so remains until the occurrence of the subsequent events (an operating loss in a succeeding taxable year)."

The Supreme Court of Pennsylvania is plainly construing "net income" in a way in which it has never

been construed by the Federal authorities. The Majority Opinion of the State court said (379 Pa. 167):[6]

> "* * * We reaffirm the Court's prior construction of the words 'net income' as ascertained by the Federal Government; and we now hold that this necessarily means gross income less all the deductions and carry-back losses ascertained and allowed taxpayer by the Federal Government under The Revenue Act of 1942."

The error in this interpretation is pointed up by the Dissenting Opinion of Mr. Justice Jones in the following statement (379 Pa. 177, 178):[7]

> "* * * The majority opinion, by construing the phrase 'ascertained by the Federal Government' to mean the taxpayer's ultimate *federal* tax liability after adjustments for deductions allowed by further federal legislation, thereby cuts down what was and still truly remains the taxpayer's net income received in the year 1944. In short, the carry-back loss provision of the federal law does not make the taxpayer's net income for the prior year any less but only its federal tax liability.
>
> "It was the income received by these corporations in the calendar year 1944 as returned by them and as ascertained (i.e., approved) by the federal government upon which the Commonwealth taxed them. * * *
>
> "The majority mistakes federal tax liability as ultimately determined for the taxable net income returned by the taxpayer and ascertained by the

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[6] Appendix, p. 56.
[7] Appendix, p. 68.

federal government * * * The federal carry-back loss provision did not make them receive less in 1944 than what they had correctly reported."

(Emphasis the Court's)

(iii) 1947 *Reenactment Did Not Violate Due Process.*

The State courts decided that the 1947 reenactment of the Corporate Net Income Tax violated the Due Process Clause of the Fourteenth Amendment of the Constitution of the United States. This conclusion was based upon the theory that, since the 1947 reenactment prohibited the carry-back of the 1946 losses to 1944, the 1947 reenactment exceeded the permissible constitutional limits of retroactivity. This interpretation was based upon a misconception of the ruling of this Court in *Welch v. Henry,* 305 U.S. 134, 59 S. Ct. 121, 83 L. Ed. 87 (1938), rehearing den. 305 U.S. 675, 59 S. Ct. 250, 83 L. Ed. 437. Regarding that case, the Supreme Court of Pennsylvania said in the present case (379 Pa. 172):[8]

"Following *Welch v. Henry,* we decide that a tax may not be retroactively applied beyond the year of the general legislative session *immediately preceding that of its enactment;* to provide otherwise constitutes a denial of due process. For this additional reason the Act of 1947 as applied in this case to 1944 corporate net income denies to each of the appellants Due Process and is void."

(Emphasis the Court's)

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[8] Appendix, p. 62.

The State Courts' construction of *Welch v. Henry*, supra, was in error because:

(a) The present cases do not involve the retroactive imposition of a tax, but the elimination of a deduction. Therefore, the statute would be retroactive only to 1946, the time when the deduction accrued. This would be well within the factual limits of *Welch v. Henry*, supra.

These cases unquestionably involve a deduction (loss carry-back) and not the imposition of additional tax. The maximum annual excise tax for the privilege of doing business in Pennsylvania in 1944 had already been paid by both taxpayers, and they are now seeking an "abatement" in such tax by the deduction of their 1946 losses.

In spite of the representations of the courts below to the contrary, the 1947 Act did not impose a new tax, nor did it increase the rate of a tax then on the books. It merely removed a deduction formerly allowed by the taxing officers under the Corporate Net Income Tax Act of 1935, as amended. This Court has regarded a deduction from income as a matter of legislative grace:

> *Interstate Transit Lines v. Commissioner*, 319 U.S. 590 (1943); 63 S. Ct. 1279, 87 L. Ed. 1607 (1943), rehearing den. 320 U.S. 809, 64 S. Ct. 26, 88 L. Ed. 489.
>
> *Deputy v. Du Pont*, 308 U.S. 488, 493 (1940), 60 S. Ct. 363, 84 L. Ed. 416 (1940).

In the latter case, the court said:

> "But allowance of deductions from gross income does not turn on general equitable considerations. It 'depends upon legislative grace.'"

It is therefore not a denial of due process to retroactively deny a deduction from gross income, since a taxpayer has no vested right in a deduction in the first instance.

To the same effect see *Jackson v. Price,* 74 F. 2d 707, 710 (2d Cir. 1935); *Manhattan General Equipment Co. v. Commissioner,* 76 F. 2d 892, 896 (2d Cir. 1935); aff'd. 297 U.S. 129, 135, 56 S. Ct. 397, 80 L. Ed. 528, rehearing denied 297 U.S. 728, 56 S. Ct. 587, 80 L. Ed. 1010.

(b) The cornerstone of the taxpayers' rights under the Due Process Clause is reliance upon the continuation of the existing status of the State tax law, together with a vested right in such status. Taxpayers here have utterly failed to show either reliance or a vested right to a 1946 net operating loss. Even if they had such a right, it could not have accrued before 1946, within the limits of *Welch v. Henry,* supra.

It is elementary that the appellees should have proven a vested right in the deduction, credit, abatement or refund which were denied by the State taxing officers in this case before they could assert that the reenactment of 1947 deprived them of any "property" without due process of law. The decisions on this point plainly indicate that appellees could not have had any vested rights in such a refund or credit of taxes paid on their corporate net income for 1944. In *Welch v. Henry,* supra, this Court held that the inconvenience to the taxpayer in being called upon, after the time for payment of a tax is past, to bear a governmental burden which he did not anticipate, is not such a vested property right as would invalidate retro-

active income taxation. A fortiori, the appellees would have even less standing constitutionally to anticipate a refund based on a deduction arising in future years.

When corporate net income taxes were settled against the appellees for the year 1944, no one questioned the correctness of the settlement or of the amount of tax paid thereunder. At the time the tax was paid, appellees had no *vested* right to receive any abatement, refund or credit thereof by reason of a hypothetical loss which might be incurred in some subsequent year. Therefore, appellees had no vested right which was protected under the Due Process Clause. See *People ex rel. Eitel v. Lindheimer,* 371 Ill. 367, 21 N.E. 2d 318, 321 (1939); *Haight v. United States,* 22 F. 2d 367, 369 (C.C.A. 9th 1927); *St. Joseph County Commissioners v. Ruckman,* 57 Ind. 96 (1877); *Grim v. Weissenberg School District,* 57 Pa. 433, 437 (1868).

Even assuming that the appellees had a vested right in a refund of taxes arising from the carry-back of losses from subsequent years, nevertheless, the Due Process Clause cannot afford any protection unless appellees can show actual reliance upon the continuance of the existing status of the alleged abatement or refund provisions. The record is devoid of any facts or other evidence to prove such reliance. There is nothing in the record to show that the Westinghouse Corporation gave any consideration to the possibility of a net operating loss in 1946 until late in 1945, after it had paid its 1944 tax without protest. The Westinghouse evidence shows that preliminary consideration was given to this problem first in October or November, 1945 (100a); the "latter part of 1945 and early

1946'' (111a); February, 1946 (113a); and that the first official consideration was at a meeting of the Executive Committee on March 15, 1946 (101a).

Consequently, it is reasonable to conclude that there could have been no official reliance by Westinghouse upon the alleged right to carry back a 1946 loss before March 15, 1946. Such ''reliance'' would not reflect back to January 1, 1944, the date as of which the Act of 1947 started to be unconstitutional under the theory of the courts below. Where the alleged unconstitutionality of a retroactive statute depends upon reliance and surprise, the period of retroactivity to be considered cannot extend beyond the point of reliance or surprise.

(c) When this Court decided in *Welch v. Henry,* supra, that the ''recent transactions rule'' included the receipt of income during the year of the legislative session immediately preceding that of its enactment, it did not rule that any income received before the year of the preceding legislative enactment automatically violated due process as the State Courts apparently believed. By thus converting the rule of constitutionality in *Welch v. Henry,* supra, to the rule of unconstitutionality in the present case, the court below misconstrued the spirit and the letter of the decisions of this Court. Retroactive legislation is not so arbitrary and oppressive as to be unconstitutional if it is no more burdensome than the taxpayer should have expected it to be when the thing which created the tax liability occurred. Cf. *Milliken v. United States,* 283 U.S. 15, 51 S. Ct. 324, 75 L. Ed. 809 (1931). As pointed out in paragraph (a) supra, the 1946 deduction made no change in the amount of 1944 net income returned

to and ascertained by the Federal Government, which is the basis of the annual excise tax for the privilege of doing business in Pennsylvania.

Therefore, the Federal Due Process questions are substantial, and ought to be reviewed by this Court, because the State Courts based their decisions in the present cases upon an interpretation of the decision of this Court in *Welch v. Henry,* supra—an interpretation which the Commonwealth believes to be contrary to the intent and meaning of the opinions of this Court.

The Commonwealth's contention as to the misconception of the retroactive principle in *Welch v. Henry,* supra, was aptly summarized in the Dissenting Opinion of Mr. Justice Jones of the Supreme Court of Pennsylvania as follows (379 Pa. 182, 183):[9]

> "* * * The error in the foregoing reasoning is at once evident. The year that the Act of 1947 struck at was not 1944 but 1946, the year of the losses which the 1947 Act conclusively and unquestionably put at an end for carry-back purposes. The spread of application which the federal law gives such losses does not determine the scope of the 1947 Act's retroactivity.
>
> "But, beyond that, the amendments of the 1947 Act did not impose any tax. They merely dispensed with any lingering thought of a carry-back of losses in determining a taxpayer's liability under the re-enacted portions of the 1935 Corporate Net Income Tax Act. A taxpayer has no

[9] Appendix, p. 74.

vested right to a deduction or exemption in determining his income subject to tax. Such allowances are a matter of legislative grace and may be taken away at any time without offending either the Federal or State Constitution. Their termination does not constitute a deprivation of property without due process. * * * Consequently, no question of constitutionality arises by reason of the retroactive aspect of the amendments to the 1947 reenactment."

Rather than misapplying the rule in *Welch v. Henry*, supra, to the instant case, it would be more appropriate to apply the rule of this court in *Illinois Central Railroad Co. v. Minnesota*, 309 U.S. 157, 60 S. Ct. 419, 84 L. Ed. 670 (1940), aff'g. 205 Minn. 621, 286 N.W. 359, where it was contended that the State tax was unconstitutional because, inter alia, it was retroactive. In upholding the validity of the State tax, this Court said (309 U.S. 164):

"* * * We have here at most a mere recomputation by the state of taxes payable under a statute which was existent throughout the whole period in question. Neglect of administrative officials, misunderstanding of the law, lack of adequate machinery, have never been constitutional barriers to a state reaching backward for taxes. Hence the case falls far short of types of retroactive tax legislation which have repeatedly been sustained by this Court, in recognition of the principle that liability for retroactive taxes is 'one of the notorious incidents of social life.' * * *"

(iv) 1947 *Reenactment Did Not Violate Equal Protection Clause*

The 1947 reenactment of the State Corporate Net Income Tax did not violate the Equal Protection Clause of the Fourteenth Amendment insofar as it enabled certain corporations which dissolved, merged, consolidated or withdrew from Pennsylvania during 1946 to secure, through an administrative interpretation of the tax laws, the allowance of carry-backs from 1946 to earlier years.

The 1947 reenactment expressly prohibited the carry-back of *all* 1946 losses, which included losses incurred by corporations which dissolved, merged, consolidated or withdrew during 1946. The tax accounts of such corporations should have been resettled by the taxing officers in accordance with the statutory prohibition against loss carry-backs. This would have followed the express language of the statute, in adopting a retroactive interpretation consistent with the construction given to the act by the State courts in considering due process (discussed in preceding subdivision iii).

Under such a construction, the act would have been unquestionably constitutional, since any discrepancy would have been the result only of the administrative nonfeasance.

See *Federal Deposit Insurance Corporation v. Board of Finance and Revenue*, 368 Pa. 463, 471, 472 (1951), 84 A. 2d 495, 499;

Commonwealth v. Brinks, Inc., 346 Pa. 296, 303, 30 A. 2d 128, 132 (1943).

Nevertheless, the State Courts have construed the 1947 reenactment of the tax law as being prospective from the date of its approval. Such a construction was an indispensable element in ruling the act unconstitutional, because otherwise the alleged discrimination against those taxpayers which did not get the benefits of the carry-back of losses would have been due to the unauthorized acts or omissions of governmental employes contrary to law. Such a prospective construction conflicts with the retroactive construction which was necessary in order to hold that the elimination of the deduction was unconstitutional under the due process clause.

However, assuming that the 1947 reenactment was prospective, and denied the carry-back deduction only as to settlements made after the effective date of the Act (May 14, 1947), the construction of the State courts that it violated equal protection was still erroneous, because the State Legislature may classify for tax purposes those corporations which have gone out of business, i.e., dissolved, merged, consolidated or withdrawn, and it is not unconstitutional to tax that class differently from the class of going corporations.

Moreover, as noted in the Petition for Reargument (Appendix D, pp. 84-85), out of the 228 corporations which merged, consolidated, dissolved or withdrew during 1946 and showed a net loss for 1946, only two received the benefit of the carry-back of such net loss as against the income of prior years. The carry-back of these losses resulted in a reduction of tax liability of $277.87, as contrasted with the millions of dollars involved in the present cases and the other cases dependent upon them. See *Commonwealth v. Brinks,*

Inc., supra. See also *Maxwell v. Bugbee*, 250 U.S. 525, 543, 40 S. Ct. 2, 7, 63 L. Ed. 1124 (1919), where this Court said:

> "* * * Absolute equality is impracticable in taxation, and is not required by the equal protection clause. And inequalities that result not from hostile discrimination, but occasionally and incidentally in the application of a system that is not arbitrary in its classification, are not sufficient to defeat the law."

The gravity of the Federal question of equal protection on this point may be measured by the total absence of harm done to the appellees and the other taxpayers of Pennsylvania by the infinitesimal favoritism ($277.87) which two corporations going out of business are alleged to have received. This is not an adequate basis for striking down the constitutionality of the provisions of the 1947 reenactment here involved. Since the Supreme Court of Pennsylvania has specifically stated in this case and other State tax cases that it is construing the Uniformity Clause in the Pennsylvania Constitution in pari materia with the Equal Protection Clause of the Federal Constitution, this Court is not precluded from asserting by its higher authority that the 1947 reenactment does not violate the Federal Constitution.

(v) *Summary*

The Federal questions raised by this appeal are substantial and should be reviewed by this Court because:

1. The decisions of the court below have been based upon a mistaken conception of the abatement allowed

by the Federal income tax laws for losses suffered by the taxpayer in years subsequent to the tax year. This misconception of the Federal law on this point resulted in the projection of the "abatement" of the tax liability of the taxpayer, through the carry-back of losses, into the State annual excise tax imposed for the privilege of doing business during the tax year, measured by each dollar of net income received during the tax year. This abatement in State tax liability also resulted in a disparity of the base and/or rate of the tax between those taxpayers which had losses in subsequent years and those which did not have such losses.

2. The State tax statute was held to be unconstitutional because of (a) the misinterpretation by the court below of the decision of this Court in *Welch v. Henry*, supra, as to the permissible limits of retroactivity, and (b) the misapplication of the rule in *Welch v. Henry*, supra, so as to construe the elimination of the possibility of a loss carry-back deduction as a retroactive increase in the tax for the tax year.

3. The court below, in holding that the State tax was unconstitutional because of invalid classification between corporations which had withdrawn from the State and corporations which were continuing to do business there, failed to recognize the plain distinction between such classes of corporations, and the de minimis nature of the alleged discrimination.

The Federal questions have been raised in a timely and proper manner, and the Commonwealth of Pennsylvania, acting through its officials, is the proper appellant.

Accordingly, jurisdiction of this appeal should be accepted by this Court.

Respectfully submitted,

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APPENDIX A

Relevant Provisions of the Pennsylvania Corporate Net Income Tax Act

(Act of May 16, 1935, P. L. 208, as reenacted and amended by the Act approved May 14, 1947, P. L. 232.) [*Italics denote new matter added by* 1947 *reenactment*]

Section 2. Definitions.—The following words, terms, and phrases, when used in this act, shall have the meaning ascribed to them in this section, except where the context clearly indicates a different meaning.

* * * * * * *

"Net Income." 1. In case the entire business of the corporation is transacted within this Commonwealth, net income for the calendar year or fiscal year as returned to and ascertained by the Federal Government, or in the case of a corporation participating in the filing of consolidated returns to the Federal Government, the net income which would have been returned to and ascertained by the Federal Government if separate returns had been made to the Federal Government for the current and prior taxable years subject, however, to any correction thereof, for fraud, evasion, or error as finally ascertained by the Federal Government: Provided, That except as hereinafter otherwise provided additional deductions shall

be allowed from net income on account of any Federal income or excess profits taxes paid after deducting therefrom an amount equivalent to any post-war refunds applicable to any such taxes during such calendar or fiscal year for the preceding calendar or fiscal year, or accrued during such calendar or fiscal year for such year, as the case may be, and on account of any dividends received from any other corporation: * * *

* * * *And provided further, That on reports filed for the calendar year one thousand nine hundred forty-six, or for any fiscal year beginning in such calendar year, or any calendar or fiscal year thereafter, no deduction shall be allowed for net operating losses sustained by the corporation during any other fiscal or calendar year, nor shall any net operating loss sustained by the corporation during the calendar year one thousand nine hundred forty-six, or during any fiscal year beginning in such calendar year, or in any calendar or fiscal year thereafter be allowed as a deduction for any prior calendar or fiscal year:* * *

2. In case the entire business of any corporation, other than a corporation engaged in doing business as an insurance or surety company, is not transacted within this Commonwealth, the tax imposed by this act shall be based upon such portion of the net income of such corporation for the fiscal or calendar year, as defined in clause one hereof, as may be determined by allocations and apportionments made as follows:

(a) Gains realized and losses sustained from the sale, or exchange of capital assets, if such assets con-

sist of real estate or tangible personal property situated in the Commonwealth, shall be allocated to this Commonwealth.

(b) Gains realized and losses sustained from the sale or exchange of capital assets, if such assets consist of real estate or tangible personal property situated outside of the Commonwealth, shall not be allocated in any part to this Commonwealth.

(c) The remainder of such net income shall be divided into three equal parts.

(1) Of one-third, such portion shall be attributed to business carried on within this Commonwealth, as shall be found by multiplying said one-third by a fraction, whose numerator is the value of the corporation's tangible property situated within this Commonwealth, and whose denominator is the value of all the corporation's tangible property wherever situated.

(2) Of one-third, such portion shall be attributed to business carried on within the Commonwealth, as shall be found by multiplying said one-third by a fraction, whose numerator is the expenditures of the corporation for wages, salaries, commissions and other compensation to its employes, and assignable to this Commonwealth as hereinafter provided, and whose denominator is the total expenditures of the corporation for wages, salaries, commissions, and other compensation to all its employes.

(3) Of the remaining third, such portion shall be attributed to business carried on within the Commonwealth, as shall be found by multiplying said third by a fraction, whose numerator is the amount of the tax-

payer's gross receipts from business assignable to this Commonwealth as hereinafter provided, and whose denominator is the amount of the taxpayer's gross receipts from all its business.

* * * * * * *

Section 3. Imposition of Tax.—Every corporation shall be subject to, and shall pay for the privilege of doing business in this Commonwealth, or having capital or property employed or used in this Commonwealth, by or in the name of itself, or any person, partnership, association, limited partnership, joint-stock association, or corporation, a State excise tax * * * at the rate of four per centum per annum upon each dollar of the net income of such corporation received by and accruing to such corporation during the calendar years one thousand nine hundred forty-three, one thousand nine hundred forty-four, * * *

* * * * * * *

Section 4. Report and Payment of Tax. * * * Such report shall set forth:

(a) A true copy of its return to the Federal Government of the annual net income arising or accruing in the calendar or fiscal year next preceding, or such part or portions of said return, as the department may designate.

* * * * * * *

Section 7. Changes Made by Federal Government.—(a) If the amount of the net income, as returned by any corporation to the Federal Government, is finally changed or corrected by the Commissioner of Internal Revenue or by any other agency or court of

the United States, such corporation, within thirty (30) days after the receipt of such final change or correction, shall make a corrected report, under oath or affirmation, to the department showing such finally changed or corrected net income, upon which the tax is required to be paid to the United States. In case a corporation fails to file a report of such correction, which results in an increase in net income within the time prescribed, there shall be added to the tax, a penalty of five dollars ($5.00) for every day during which such corporation is in default, but the department may abate any such penalty in whole or in part.

(b) If, as a result of such final change or correction, there should be any change made in the amount of the net income of any corporation upon which tax is imposed by this act, the department shall have the power, and its duty shall be to resettle such taxes. Whenever a resettlement shall have been made hereunder, the department shall resettle the account according to law, and shall credit or charge, as the case may be, the amount resulting from such resettlement upon the current accounts of the corporation with which it is made. The resettlement shall be subject to audit and approval by the Department of the Auditor General, as in the case of original settlements, and in case of the failure of the two departments to agree, the resettlement shall be submitted to the Board of Finance and Revenue, as in the case of original settlements.

* * * * * * *

(d) The provisions of this section shall not be construed so as to permit a resettlement based upon the allowance of any deduction on account of net operating losses, sustained in other fiscal or calendar years, that are not allowed as deductions under the definition of "Net Income", as contained in section two of this act.

Section 8. Settlement and Resettlement.—(a) All taxes due under this act shall be settled by the department, and such settlement shall be subject to audit and approval by the Department of the Auditor General, and shall, so far as possible, be made so that notice thereof may reach the taxpayer before the end of a year after the tax report was required to be made.

(b) Promptly after the date of any such settlement, the department shall send, by mail or otherwise, a copy thereof to such corporation. The tax imposed by this act shall be settled, resettled, and otherwise imposed and adjusted in the same manner, within the same periods of time, and right of resettlement, review, appeal, and refund, as provided by law in the case of capital stock and franchise taxes imposed upon corporations.

(c) If, within a period of two years after the date of any settlement, the department is not satisfied with such settlement, or if at any time the net income as returned by any corporation to the Federal Government is finally changed or corrected by the Commissioner of Internal Revenue or by any other agency or court of the United States with the result that tax, in addition to the amount paid, is due under this act, the department is hereby authorized and empowered

to make a resettlement of the tax due by such corporation, based upon the facts contained in the report, or upon any information within its possession or that shall come into its possession.

* * * * * * *

APPENDIX B

Majority Opinion of the Supreme Court of Pennsylvania

Opinion by Mr. Justice Bell, June 28, 1954:

These cases involve the same basic question and were argued together and will be treated as one in this opinion.

The question involved may be narrowed to whether §2 of the Corporate Net Income Tax Act of May 14, 1947, P. L. 232, in its application to taxpayers' 1944 corporate net income is constitutional.

Each of the taxpayers is a Pennsylvania corporation; each is engaged in both intra-state and inter-state business; and each was subject to Pennsylvania Corporate Net Income Tax for the years 1944, 1945 and 1946. Each taxpayer duly filed with the Department of Revenue its corporate net income tax report for the year 1944 and each paid the tax shown therein to be due. In 1946 each of the taxpayers suffered a net operating loss which was allowed by the Commissioner of Internal Revenue *and was applicable under the (Federal) Revenue Act of 1942 to the taxpayer's 1944 income.*

The Corporate Net Income Tax Act was first enacted by the Act of May 16, 1935, P. L. 208 for a lim-

ited period of two years. It was thereafter reenacted up to and including 1945 (with amendments not here relevant), by every subsequent regular session of the legislature. It was denominated a state excise tax. Section 2 of the Act of May 7, 1943, P. L. 217 (and of the Act of April 11, 1945, P. L. 190) provided: "Section 2. Definitions.—The following words, terms, and phrases, when used in this act, shall have the meaning ascribed to them in this section, except where the context clearly indicates a different meaning. . . .

" 'Net Income.' 1. . . . net income for the calendar year or fiscal year as returned to and *ascertained by the Federal Government,** . . ."

Section 3 of the said Acts provided as follows: "Every corporation shall be subject to, and shall pay for the privilege of doing business in this Commonwealth, or having capital or property employed or used in this Commonwealth, . . . a State excise tax . . . at the rate of four per centum per annum upon each dollar of *net income* of such corporation received by, and accruing to, such corporation during the calendar year . . . one thousand nine hundred forty-four."

The Commonwealth ignores the definition of "net income" and limits it to the net income actually received by the corporation during the calendar year. We do not agree with this construction.

The Commonwealth adopted as the base of its tax for determining the tax liability of corporations for the years 1943, 1944 (and by the Act of 1945 supra,

* Italics throughout, ours.

the years 1945 and 1946), the amount of *net income* "as returned to and *ascertained* by the Federal Government." Because of the losses which would likely be incurred in converting from wartime to peacetime business, the Revenue Act of 1942 provided that net operating losses could be carried back for the two years immediately preceding the loss year. That meant that each of these taxpayers could, under the Revenue Act of 1942, carry back its net operating loss in 1946 and apply it in reduction of its 1944 income. For the years 1941 to 1945 inclusive, the Department of Revenue and the Department of the Auditor General, in making corporate net income tax settlements and resettlements, allowed deductions for net operating loss carry-backs to the extent that corporations were permitted to do so under the Federal law.

The Commonwealth by Act of *May 14, 1947*, supra, amended the 1943 (and 1945) Acts by providing, inter alia: "Section 2. . . . And provided further, That on reports filed for the calendar year one thousand nine hundred *forty-six*, . . . or any calendar or fiscal year thereafter, no deduction shall be allowed for net operating losses sustained by the corporation during any other fiscal or calendar year, *nor shall any net operating loss sustained by the corporation during* the calendar year one thousand nine hundred *forty-six*, . . . or in any calendar or fiscal year thereafter *be allowed* as a deduction *for any prior* calendar or fiscal *year* . . . ."

"Section 13. This Act shall become effective *immediately* upon its final enactment . . . ."

The Commonwealth contends that this amendment as applied to 1944 corporate net income is valid and constitutional, and that it made no change in the tax base of the prior Acts so far as carry-back losses are concerned.

The first question that arises is, what is the meaning of "net income" as used in the Acts prior to 1947 and more particularly do they permit carry-back losses sustained in 1946 to be deducted in ascertaining 1944 net income?

Pennsylvania chose and adopted *as the base* for determining the tax liability of corporations for the years 1943 to 1946 inclusive, the amount of *net income* as returned to and *ascertained* by the Federal Government, with full knowledge that The Revenue Act of 1942 allowed carry-back losses for the two years immediately preceding the loss year. But Pennsylvania went much further than this. During the month of June, *1946*, in order to attract business to the Commonwealth and to retain within the Commonwealth as much corporate business as possible, Governor Martin and other high officials of the State advertised in the leading newspapers on the Atlantic seaboard as follows: "There are provisions for carry back and carry forward of corporate losses for purposes of State corporate income tax calculations which result in an effective average method of determining taxable income."

Governor Duff, in his Budget Message in January, *1947*, recommended *a change* in the corporate net in-

come tax in order to obtain increased revenue. He said, inter alia: " . . . One of the principal reasons [for the lower than anticipated receipts from the corporate net income tax] is that this State allows the carry-back, carry-forward of losses as provided in the Federal Corporate Income Tax. *Under this provision losses incurred in the current year may be carried back two years* to be established as credits against taxes paid in these years or may be carried forward two years similarly. . . .

"The carry-back, carry-forward provision was made a part of the Federal Tax Act in order to help to spread the burden of the high Federal taxes. Pennsylvania in using the Federal base did not exclude the operation of this provision as has been done in some other states. Of all the states having a corporate net income tax, this State alone permits the operation of this provision."

Moreover, each of the taxpayers, in reliance on the law, i.e., the Act of 1943 and the Act of 1945, and on the Commonwealth's advertisements and its practice prior to May 14, 1947, of allowing deductions for operating loss carry-backs to the extent permitted under the Federal law, made vital decisions and commitments, and in connection with mergers and a sale of debenture bonds and preferred stock, issued to its stockholders (in connection with possible purchases of stock), and to the buying public and to the (Federal) Securities and Exchange Commission, statements of taxpayer's right to carry-back operating losses for the two years in question.

Taxpayers contend that if this Act of 1947 is interpreted retroactively, as the Commonwealth contends it should be, the refusal to allow the carry-back to 1944 of a net operating loss sustained by the corporation in the year 1946, is unconstitutional for the reason that it violates (a) the Due Process Clause of the Fourteenth Amendment (Article XIV, §1) of the Constitution of the United States, and of Article I, §§9 and 10 of the Constitution of Pennsylvania, and (b) the Equal Protection Clause of the Fourteenth Amendment of the Constitution of the United States and the Uniformity Clause of Article IX, §1 of the Constitution of Pennsylvania, and (c) the Impairment of Contracts Clause of Article I, §10 of the Constitution of the United States, and of Article I, §17 of the Constitution of Pennsylvania.

It would be regrettable if the law required us to sustain the Commonwealth's present contention that the Act of 1943 never permitted any carry-back losses in the computation of corporate net income and that the 1947 Act should be retroactively applied, because it would constitute an obvious breach of faith by the Commonwealth and be very unfair and unjust to the public and the stockholders who bought stocks or bonds of the taxpayers (on the faith of important statements which taxpayers properly made in reliance on representations of the Commonwealth's highest officials) as well as to the Securities and Exchange Commission and to each of the taxpayers here involved. We recently decided in *Commonwealth v. Western Maryland Rwy. Co.*, 377 Pa. 312, 320-321, 105 A. 2d 336, upon somewhat similar facts, that the Com-

monwealth could not be estopped by the public statements or official acts of some of the Commonwealth's highest officials. We need not decide whether that principle would apply to the facts in the instant case, because the 1947 Act if retroactively applied to 1944 net income, clearly violates both the Federal Constitution and the State Constitution.

The Act of 1943, as reenacted in 1945, being a tax act and not an act providing, as the Commonwealth contends, for exemptions or deductions, must be strictly construed against the Commonwealth and all reasonable doubts must be resolved in favor of the taxpayer: *Allentown School District Mercantile Tax Case,* 370 Pa. 161, 171, 87 A. 2d 480; *Murray v. Philadelphia,* 364 Pa. 157, 71 A. 2d 280; *Commonwealth v. Repplier Coal Co.,* 348 Pa. 372, 35 A. 2d 319.

This Court has already decided that the prior Acts, i.e., prior to 1947, adopt as a tax base the "Net income as ascertained [by the Federal Government] . . . How it was fixed by the Federal authorities is of no concern to the taxing officers of the Commonwealth nor to its statute." *Commonwealth v. Warner Bros. Theatres, Inc.,* 345 Pa. 270, 27 A. 2d 62; *Commonwealth v. Electrolux Corp.,* 362 Pa. 333, 339, 67 A. 2d 105. We reaffirm the Court's prior construction of the words "net income" as ascertained by the Federal Government; and we now hold that this necessarily means gross income less all the deductions and carry-back losses ascertained and allowed taxpayer by the Federal Government under The Revenue Act of 1942.

We agree with the taxpayers' contention that the Act of 1947, by its terms and in its operation and effect, arbitrarily and unreasonably discriminates against them and therefore violates the Uniformity Clause of the Pennsylvania Constitution and the Fourteenth Amendment of the Federal Constitution which—so far as reasonableness of classification is concerned, or as applied to questions of taxation—stand in pari materia: *Allentown School District Mercantile Tax Case*, 310 Pa., supra; *Commonwealth v. Fireman's Fund Insurance Co.*, 369 Pa. 560, 565, 87 A. 2d 255; *Commonwealth v. Girard Life Insurance Co.*, 305 Pa. 558, 562, 158 A. 262.

In *Allentown School District Mercantile Tax Case*, 370 Pa., supra, we said (pages 167, 170): "Article IX, section 1, of the Constitution of Pennsylvania, provides, 'All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws; . . .' This means that the classification by the legislative body must be reasonable and the tax must be applied with uniformity upon similar kinds of business or property and with substantial equality of the tax burden to all members of the same class: Commonwealth v. Girard Life Insurance Co., 305 Pa. 558, 158 A. 262; Knisely v. Cotterel, 196 Pa. 614, 46 A. 861; Dufour v. Maize, 358 Pa. 309, 56 A. 2d 675; Commonwealth v. McCarthy, 332 Pa. 465, 3 A. 2d 267; Dole v. Philadelphia, 337 Pa. 375, 11 A. 2d 163.

. . .

". . . While taxation is not a matter of exact science and perfect uniformity and absolute equality in taxation can rarely ever be attained (Wilson v. Philadelphia, 330 Pa. 350, 352, 198 A. 893), the imposition of taxes which are to a substantial degree unequal in their operation or effect upon similar kinds of business or property, or *upon persons in the same classification, is prohibited*: Cf. Com. v. Overholt & Co., Inc., 331 Pa. 182, 190-191, 200 A. 849; Pollock v. Farmers' Loan and Trust Co., 157 U. S. 429, 599. Moreover while reasonable and practical classifications are justifiable, where a formula or method of computing a tax will, in its operation or effect, produce arbitrary or unjust or unreasonably discriminatory results, the constitutional provision relating to uniformity is violated: Turco Paint & Varnish Co. v. Kalodner, 320 Pa. 421, 184 A. 37; Hans Rees' Sons v. North Carolina, 283 U. S. 123."

The *1947* Act amended, as we have seen, the definition of net income in §2 of the prior Acts, and in its relevant provisions provides: ". . . nor shall net operating loss sustained by the corporation during the calendar year one thousand nine hundred forty-six . . . be allowed as a deduction for any prior calendar . . . year." Section 7 of the *1943* Act and of the 1945 Act provided as follows: "Section 7. Changes Made by Federal Government.—(a) If the amount of the net income, as returned by any corporation to the Federal Government, is finally changed or corrected by the Commissioner of Internal Revenue or by any other agency or court of the United States, such corporation, within thirty (30) days after the receipt of such

final change or correction, shall make a corrected report, under oath or affirmation, to the department showing such finally changed or corrected net income, upon which the tax is required to be paid to the United States."

This Section was amended in 1947 by adding subsection: "(d) The provisions of this section shall not be construed so as to permit a resettlement based upon the allowance of any deduction on account of net operating losses, sustained in other fiscal or calendar years, that are not allowed as deductions under the definition of 'Net Income', as contained in section two of this act." The Act of 1947 then provided that it should become effective *immediately* upon its final enactment, viz., May 14, 1947.

The effect of the amendments in the Act of 1947 are these: No resettlement which was based upon the allowance of any deduction for operating losses sustained in 1944 or 1945 or 1946 could be made *after May 14, 1947.*

The Act of 1947 means, and it was so interpreted by the fiscal and administrative officers of the Commonwealth, as the Chancellor found, based upon adequate evidence, that in case corporations sustained net operating losses in 1946 and because of going out of business or because of a merger or consolidation or a withdrawal from the State or for any other reason, obtained from the Commonwealth a resettlement of its taxes prior to May 14, 1947, that resettlement, with its deduction for a carry-back loss sustained in 1946, was valid; but other corporations of the same class,

with net operating losses sustained in 1946, were not entitled to a deduction therefor if no resettlement had been made prior to May 14, 1947. In other words, corporations of the same class, each having net operating losses in 1946, are treated radically differently, *depending solely upon the date of resettlement.* The liability or non-liability for (a higher) tax was made to depend, not upon the amount of net income as ascertained by the Federal Government, not upon a corporation's net operating loss in 1946, not upon a justifiable classification of corporations, but solely upon whether a resettlement of carry-back losses for 1946 and prior years was made by the fiscal or administrative officers of the Commonwealth prior or subsequent to May 14, 1947. Such a classification, such a tax, is arbitrary and unreasonably discriminatory; the tax is not applied with substantial equality of the tax burden to all members of the same class. The effect of the Act is to produce arbitrary, unjust and unreasonably discriminatory results and, for these reasons, it violates, so far as these taxpayers are concerned, Article IX, §1 of the Pennsylvania Constitution and §1 of the Fourteenth Amendment of the Constitution of the United States.

The Commonwealth further contends that even if the Act of 1943 permitted a deduction from 1944 net income of carry-back losses suffered in 1946, the legislature can change and prohibit this in 1947. We find no merit in this contention.

An Act of Congress or an Act of the legislature of Pennsylvania which imposes a retroactive tax is not

unconstitutional per se merely because it is retroactive in its language or in its operation: *Billings v. United States,* 232 U. S. 261, 282; *Milliken v. United States,* 283 U. S. 15, 21; *Welch v. Henry,* 305 U. S. 134; *Shirks Motor Express Corp. v. Messner,* 375 Pa. 450, 462, 100 A. 2d 913.

While a principle more favorable to the taxpayer has been applied in gift tax cases (See *Untermyer v. Anderson,* 276 U. S. 440, and *Nichols v. Coolidge,* 274 U. S. 531), laws or acts imposing income taxes or excise taxes, or property taxes have been sustained even though applied retroactively during the year of the session in which the taxing statute is enacted, and in some instances during the year of the preceding session. These statutes were sustained even though they increased the tax burden by imposing new taxes or increasing the rates of old ones, or both; and the retroactive effect was held not to constitute a denial of due process under either the United States or the Pennsylvania Constitutions: *Shirks Motor Express Corp. v. Messner,* 375 Pa., supra; *Welch v. Henry,* 305 U. S., supra; *Stockdale v. The Insurance Companies,* 20 Wall. 323. It is obvious, however, that there must be some limitation on the right of a legislative body to pass laws imposing taxes retroactively, for otherwise a legislature could constitutionally impose new or increased taxes retroactively for a period of 25 or 50 years which would be so onerous or confiscatory and unjust as to bankrupt the individuals or corporations thus taxed. This was recognized in *Welch v. Henry,* 305 U. S., supra, where the Court sustained an Act of Wisconsin passed in *1935* which for the first

time taxed corporate dividends received by taxpayer in the year *1933*, a return of which was not due, however, under Wisconsin law, until March 15, *1934*. Justice Stone said (pages 149, 150): ". . . The contention that the retroactive application of the Revenue Acts is a denial of the due process guaranteed by the Fifth Amendment has been uniformly rejected. Stockdale v. Insurance Companies, 20 Wall. 323, 331; Railroad Co. v. Rose, 95 U. S. 78, 80; Flint v. Stone Tracy Co., 220 U. S. 107; Billings v. United States, 232 U. S. 261, 282; Brushaber v. Union Pacific R. Co., 240 U. S. 1, 20; Lynch v. Hornby, 247 U. S. 339, 343; LaBelle Iron Works v. United States, 256 U. S. 377. . . . And we think that the 'recent transactions' to which this Court has declared a tax law may be retroactively applied, Cooper v. United States, 280 U. S. 409, 411, must be taken to include the receipt of income during the year of the legislative session preceding that of its enactment."

Following *Welch v. Henry*, we decide that a tax may not be retroactively applied beyond the year of the general legislative session *immediately preceding that of its enactment;* to provide otherwise constitutes a denial of due process. For this additional reason the Act of 1947 as applied in this case to 1944 corporate net income denies to each of the appellants Due Process and is void.

The case of *Commonwealth v. Chambersburg Engineering Co.*, 287 Pa. 54, 134 A. 408, is distinguishable because, inter alia, the tax base there was the net income as *returned* to—not ascertained by—the

Federal Government. In the instant case neither the Commonwealth nor either of these defendants could know the net income which was its taxable base for the year 1944 until the Federal Government had finally ascertained taxpayer's 1944 net income after deducting net operating losses incurred in 1946. The legislature obviously realized this and even provided in §7 for a report of change in net income and for a resettlement of the tax where changes occurred and did not, as the Commonwealth contends, limit this to fraud or mistake.

The Commonwealth's further contention that the Acts of 1943 and of 1945 as thus interpreted violate the Uniformity Clause, Article IX, §1 of the Constitution of Pennsylvania is without merit—the rate of tax is the same and the tax base is the same for every corporation of the same class, and therefore there is no lack of uniformity: *Commonwealth v. Warner Bros. Theatres, Inc.*, 345 Pa., supra; *Turco Paint & Varnish Co. v. Kalodner*, 320 Pa. 421, 184 A. 37.

We deem it unnecessary to discuss the other contentions made by appellant or by appellees.

The judgment in each case is affirmed.

Mr. Chief Justice Horace Stern and Mr. Justice Arnold concurred in the result.

Mr. Justice Chidsey took no part in the consideration or decision of these cases.

APPENDIX C

Dissenting Opinion By Mr. Justice Jones

If the majority opinion is in error, as I firmly believe it to be, the unfortunate result is that the claimant taxpayers are unjustly rewarded at the expense of the Commonwealth with large refunds which can only be properly characterized as copious windfalls. If ever there was a case where the court should, of its own motion, order a reargument, this is one. The attendant delay in the final disposition of the appeals would be relatively brief.[1]

In 1942, Congress in order to relieve corporations from the hardship of anticipated heavy losses in the

[1] It was January 14, 1949, when the Budd Company appealed to the court below from the adverse decision of the Board of Finance and Revenue. A like appeal by Westinghouse Electric Corporation was filed on February 8, 1950. Both appeals were tried together to the court below, without a jury, on January 23, 1951. Judgment in favor of Westinghouse for a credit of $958,832.88 against the Commonwealth was entered on September 29, 1952, while judgment in favor of Budd for a credit of $284,392.39 against the Commonwealth was entered on October 20, 1952. Exceptions by the Commonwealth to both judgments were argued before the court en banc on January 29, 1953; the exceptions were dismissed and the judgments confirmed by order of the court below on June 29, 1953. From the judgments thus made final, the instant appeals were taken to our May Term, 1954, and were argued in this court on January 12, 1954.

post-war conversion of industry to peace-time operations, amended the Internal Revenue Code by permitting resettlements of federal income tax liabilities by carrying back losses for two years immediately preceding the year of such losses. At that time (1942) Pennsylvania had a corporate net income tax which was first levied for a limited period of two years by the Act of May 16, 1935, P. L. 208, but which has since been regularly re-enacted biennially by each succeeding general session of the legislature. The tax so imposed subjected every corporation to the payment of a State excise tax for the privilege of doing business within the Commonwealth at a specified rate per annum upon each dollar of net income of such corporation "as returned to and ascertained by the Federal Government . . ."

After the Internal Revenue Code had been amended in 1942 so as to include, inter alia, the carry-back loss provision, fiscal officers of the Commonwealth assumed to allow to corporations, subject to the Pennsylvania corporate net income tax, the privilege of carrying back losses from one year to another in order to reduce the net income of a priorly reported and already settled tax year liability and thus lay the groundwork for a claim for refund. That course appears to have been followed by the fiscal officers of the Commonwealth until the year 1947.

Upon the biennial re-enactment of the corporate net income tax by Act of May 14, 1947, P. L. 232, the legislature provided that in determining the annual net income of a corporation subject to the tax ". . . no deduction shall be allowed for net operating losses

sustained by the corporation during any other fiscal or calendar year, nor shall any net operating loss sustained by the corporation during the calendar year one thousand nine hundred forty-six, or during any fiscal year beginning in such calendar year, or in any calendar or fiscal year thereafter be allowed as a deduction for any prior calendar or fiscal year."

Westinghouse, having determined a large net operating loss for the year 1946, filed with the Department of Revenue on April 22, 1947, a formal Report of Change in corporate net income for the year 1944. In the Report, Westinghouse calculated an overpayment of taxes for that year by carrying back a portion of the losses suffered in 1946. Thereby, it sought to reduce *pro tanto* its net operating income for the year 1944 which it had theretofore duly and correctly reported to the Department of Revenue and the corporate net income tax due whereon it had paid *in full* in April and May, 1945. Budd, having sustained a large net operating loss in 1946, also filed with the Department of Revenue a formal Report of Change in its corporate net income for the year 1944 and likewise calculated an overpayment of tax by carrying back a portion of the losses it had suffered in 1946 under the same accounting procedure as was followed by Westinghouse. The Deputy Secretary of Revenue acknowledged receipt of these Reports of Change and filed them without taking action thereon, asserting that the Act of 1947, supra, prohibited the carrying back of net operating losses for the year 1946 when reporting income to the Commonwealth. The Commonwealth's fiscal officers later refused the resettlement of tax liability for the year 1944 requested by Westinghouse

and by Budd on the basis of their Reports of Change. On petitions by both corporations to the Board of Finance and Revenue for a review, the Board refused the petitions and sustained the action of the fiscal officers. It was from the orders of the Board of Finance and Revenue that the taxpayers appealed to the court below which, as already stated, entered judgments for the respective taxpayers.

In so doing, the learned court below held that the amendments contained in the 1947 re-enactment of the Corporate Net Income Tax Act violated the due process and equal protection clauses of the Fourteenth Amendment of the Federal Constitution and the due process clause (Art. I, Sec. 9) and the uniformity clause (Art. IX, Sec. 1) of the State Constitution. With those conclusions, or any of them, I completely disagree. I do agree, however, with the able Deputy Attorney General that the Corporate Net Income Tax Act, as amended and re-enacted by the Act of May 14, 1947, P. L. 232, is valid for either of the two following reasons: (1) the amendatory provisions of the Act were but declaratory of existing law and (2) even if the Act made a substantial change in the prior law, it did so constitutionally.

It is too plain for discussion that, in enacting the Corporate Net Income Tax Act of 1935, the legislature did not intend to allow a carry-back of loss in one calendar or fiscal year to reduce a corporate taxpayer's net income base of a prior year upon which the taxpayer's liability for the privilege of doing business in Pennsylvania in a particular year was founded. It was not until seven years after the enactment

of the Act of 1935 (viz., in 1942) that Congress first enacted the carry-back loss provision for determining a taxpayer's federal income tax liability for a given year. And, three successive biennial general sessions of the legislature (1937, 1939 and 1941) had re-enacted the Corporate Net Income Tax Act of 1935, *ipsissimis verbis,* before the carry-back loss provision ever appeared in the Internal Revenue Code.

What the legislature did by the Act of 1935 and by the subsequent re-enactments of that Act was to impose by Section 3 "a State excise tax . . . at the rate of six per centum per annum upon each dollar of net income of such corporation received by, and accruing to, such corporation" during the taxable year currently under consideration. For the purpose of determining the corporation's net income for the taxable year, Section 2 of the Act defines net income as being the net income "as returned to and ascertained by the Federal Government." And, that is exactly the basis upon which the Commonwealth taxed these corporations for the year 1944. The majority opinion, by construing the phrase "ascertained by the Federal Government" to mean the taxpayer's ultimate *federal* tax liability after adjustments for deductions allowed by further federal legislation, thereby cuts down what was and still truly remains the taxpayer's net income received in the year 1944. In short, the carry-back loss provision of the federal law does not make the taxpayer's net income for the prior year any less but only its federal tax liability.

It was the income received by these corporations in the calendar year 1944 as returned by them and as

ascertained (i.e., approved) by the federal government upon which the Commonwealth taxed them. Witness the $57,000,000 plus federal refund that Westinghouse received in 1947 on the tax it had paid on its 1944 income as returned by it and as ascertained by the federal government which was the net income upon which Pennsylvania also taxed Westinghouse. Had that income not been ascertained by the federal government, Westinghouse would not have paid its federal taxes thereon as it obviously did.

The majority mistakes federal tax liability as ultimately determined for the taxable net income returned by the taxpayer and ascertained by the federal government. Neither Westinghouse's nor Budd's net income for the year 1944, as reported by them to the Department of Revenue, has ever been changed by so much as a penny. True enough, the federal government granted them large refunds on their federal income taxes for 1944 by reason of further deductions federally allowed. But that had nothing whatsoever to do with their liability for the Pennsylvania corporate net income tax on each dollar of net income received by them in 1944. The federal carry-back loss provision did not make them receive less in 1944 than what they had correctly reported.

When the legislature enacted the Corporate Net Income Tax Act of 1935 it is legally presumed to have been cognizant of the decision of this court in *Commonwealth v. Chambersburg Engineering Company*, 287 Pa. 54, 57, 58, 134 A. 408. That case involved the Pennsylvania Emergency Profits Tax Act of 1923, P. L. 876, which is substantially similar to the Act

of 1935, supra. It imposed a tax "upon each dollar of the net income of such corporation, during the calendar years" 1923 and 1924. It defined net income as "net income for the calendar or fiscal year as returned to the Federal Government . . ." and required the taxpayer to furnish the Auditor General with a true copy of its federal tax return. In the *Chambersburg* case the taxpayer had deducted on its State return for 1923 a net loss suffered in 1921 which was a permissible deduction under the federal income tax law then in effect. In sustaining the Auditor General's disallowance of this deduction, we there said,— "Appellant contends that the net income of a corporation upon which the emergency profits tax is to be paid, is the amount of net income upon which income tax is required to be paid to the United States. We do not so construe the act. It defines net income as the net income *returned* to the federal government, not that on which tax is paid to it, and assesses the tax 'upon each dollar of the *net income* of such corporation' during the two years 1923 and 1924. From no language of the act can the inference arise that, so far as the State of Pennsylvania is concerned, losses sustained in prior years are to be deducted from the net income for the two enumerated years. . . . But our act . . . assesses the tax on the actual net income for the named years, not the sum to be taxed as arrived at by the federal authorities after such deductions as may seem proper to them." The majority opinion assumes to distinguish the *Chambersburg* case by saying that the statutory imposition there was upon the net income as "*returned* to the Federal Government." That is a wholly immaterial differentia-

tion. The addition of the words "ascertained by" would not have altered the decision in the *Chambersburg* case; its rationale plainly so confirms.

The basis for the taxpayers' claims here involved emanates solely from the unwarranted action of the State's fiscal officers in disregarding the plain terms of the Pennsylvania Corporate Net Income Tax Act and in according to taxpayers the privilege of resettling their tax liabilities by application of the carry-back loss provision of the Internal Revenue Code. Just when, it may be asked, did that become a part of the Pennsylvania statute? It is the Pennsylvania Act and not the federal income tax law that imposes Pennsylvania's corporate net income tax. In *Commonwealth v. Curtis Publishing Co.*, 363 Pa. 299, 308-309, 69 A. 2d 410, cert. denied, 339 U. S. 928, this court ruled that the interest on United States securities must be eliminated from the federally shown net income base in imposing the Pennsylvania corporate net income tax inasmuch as income from State and municipal securities was not included in such base. In so holding, we said,—"This anomaly arises from the fact that the Pennsylvania Taxing Act takes the corporation's annual return as made to and ascertained by, the Federal Government as the basis of the annual tax it imposes on corporations doing business in Pennsylvania. But this *bookkeeping* fact does not affect the *political* fact that the command to tax the net income emanates from the sovereignty of Pennsylvania and not from the sovereignty of the United States. By adopting this mode of *ascertaining* the tax to be imposed Pennsylvania did *not* delegate to the Federal

government any of the State's power to tax. *The act of taxing is the act of the Commonwealth of Pennsylvania.*"

The majority opinion dwells on the unwarranted past action of the State's fiscal officers as well as gratuitous statements of two Governors and a cabinet member to demonstrate that Pennsylvania allowed the use of the federal carry-back provision in determining a taxpayer's liability for the Pennsylvania corporate net income tax. But, as Chief Justice Stern said for this Court in *Federal Deposit Insurance Corporation v. Board of Finance & Revenue,* 368 Pa. 463, 472, 84 A. 2d 495,—"An administrative body cannot, by mere usage, invest itself with authority or powers not fairly or properly within the legislative grant; it is the law which is to govern rather than departmental opinions in regard to it: [citing authorities]." It seems all too implicit in the majority opinion that, because of the action of the State's fiscal officers and its executives in respect of Pennsylvania's asserted use of the federal carry-back loss provision and the assumption that the instant taxpayers and purchasers of their securities had relied upon these statements and pronouncements, the Commonwealth is estopped from enforcing its Corporate Net Income Tax Act without permitting use of the federal carry-back loss provision. For, while adverting to this court's recent germane decision in *Commonwealth v. Western Maryland Railway Company,* 377 Pa. 312, 320-321, 105 A. 2d 336, the majority opinion nevertheless says it is unnecessary now to decide whether there can be an estoppel against a sovereign. The *Western Maryland*

case leaves not the slightest doubt that *there can be no estoppel against the sovereign* acting in its governmental capacity. As Chief Justice Stern said in the *Western Maryland* case,—"We find no basis whatever for the contention that the Commonwealth has been estopped by reason of the failure of officials who, acting under a mistaken impression of the applicable law, either did not impose the taxes or compromised them for lesser amounts than were properly due. . . . It is a fundamental legal principle that a State or other sovereignty cannot be estopped by any acts or conduct of its officers or agents in the performance of a governmental as distinguished from a proprietary function. No errors or misinformation of officers or agents can estop the government from collecting taxes legally due. However firmly established the rule as to private individuals or corporations that where a person has been induced to act to his detriment by the representations of an agent he can hold the principal on a theory of estoppel, that rule does not apply when a government is the principal."

There was no time prior to 1947 when the carry-back loss provision of the Federal Internal Revenue Code was a part of the Pennsylvania Corporate Net Income Tax Act either by implied reference or otherwise; nor was the carry-back loss provision to be reckoned with in determining such tax. But even if it was applicable in ascertaining a taxpayer's liability for the Pennsylvania tax, the Act of May 14, 1947, P. L. 232, very definitely eliminated it.

No authority need be cited for the proposition that a taxing statute is not unconstitutional merely be-

cause it operates retroactively. The majority opinion concedes as much and quotes from Justice Stone in *Welch v. Henry*, 305 U. S. 134, 149, 150, to the effect that "The contention that the retroactive application of the Revenue Acts is a denial of the due process guaranteed by the Fifth Amendment has been uniformly rejected. . . . And we think that the 'recent transactions' to which this Court has declared a tax law may be retroactively applied [citing case] must be taken to include the receipt of income during the year of the legislative session preceding that of its enactment." From that, the majority "decide that a tax may not be retroactively applied beyond the year of the general legislative session *immediately preceding that of its enactment*; to provide otherwise constitutes a denial of due process. For this additional reason the Act of 1947, as applied in this case to 1944 corporate net income denies to each of the appellants [sic] Due Process and is void." The error in the foregoing reasoning is at once evident. The year that the Act of 1947 struck at was not 1944 but 1946, the year of the losses which the 1947 Act conclusively and unquestionably put at an end for carry-back purposes. The spread of application which the federal law gives such losses does not determine the scope of the 1947 Act's retroactivity.

But, beyond that, the amendments of the 1947 Act did not impose any tax. They merely dispensed with any lingering thought of a carry-back of losses in determining a taxpayer's liability under the re-enacted portions of the 1935 Corporate Net Income Tax Act. A taxpayer has no vested right to a deduction or ex-

emption in determining his income subject to tax. Such allowances are a matter of legislative grace and may be taken away at any time without offending either the Federal or State Constitution. Their termination does not constitute a deprivation of property without due process. In *Deputy v. DuPont,* 308 U. S. 488, 493, the Supreme Court said that the ". . . allowance of deductions from gross income does not turn on general equitable considerations. It 'depends upon legislative grace.' " See also *Interstate Transit Lines v. Commissioner of Internal Revenue,* 319 U. S. 590. Consequently, no question of constitutionality arises by reason of the retroactive aspect of the amendments to the 1947 re-enactment.

The contention that the amendments in the re-enactment of 1947 offend against the uniformity clause of the State Constitution and the equal protection clause of the Fourteenth Amendment are patently without merit. Any supposed want of uniformity or equal protection is ascribable alone to the error of the taxing officers in allowing carry-back deductions in resettling the Pennsylvania corporate income tax liability of a few isolated corporations which had dissolved, merged, consolidated or withdrawn during 1946.

Actually, the only want of uniformity under Art. IX, Sec. 1, of the Pennsylvania Constitution results from this court's authentication of the appellees' claims for refunds.

I would reverse the judgments of the court below and direct the reinstatement of the orders of the Board of Finance and Revenue.

APPENDIX D

Petition of the Commonwealth of Pennsylvania For Reargument

To the Honorable, the Justices of Said Court:

The Commonwealth of Pennsylvania, appellant in the above-captioned appeals, respectfully petitions Your Honorable Court for reargument of the issues involved in said appeals, and for reconsideration of the conclusions and rulings contained in the Majority Opinion of this Court filed June 28, 1954 by Mr. Justice Bell. The Commonwealth further avers that such reargument should be granted for the following reasons:

1. The Majority Opinion, in construing the Corporate Net Income Tax Act, inaccurately concluded (p. 2; semble p. 3) that "The Commonwealth adopted as the base of its tax for determining the tax liability of corporations * * * the amount of *net income* 'as returned to and *ascertained* by the Federal Government' ". On the contrary, the Legislature adopted as the base of the tax "each dollar of net income of such corporation received * * * during the calendar year".[1] The base for this tax is determined by the imposition section (Section 3).

[1] Commonwealth's original Westinghouse Brief (hereinafter referred to as Commonwealth's Brief) pp. 7-14.

2. The Majority Opinion concluded (p. 2) that "The Commonwealth ignores the definition of 'net income' and limits it to the net income actually received by the corporation during the calendar year". Presumably, the term "Commonwealth" means the appellant in this case, which is being represented by the Executive Branch of the Government. The appellant does not ignore the definition of net income, but contends that the function of a definition is to define terms used elsewhere throughout the statute.[2] The definition of net income is not limited in that function, but the purpose of these proceedings is to ascertain the legislative intent. It is not the Executive Branch, but the *Legislative* which expressly limited the tax base to net income received by the corporation *during the calendar year*.

3. The Majority Opinion concludes that "Pennsylvania went much further than" adopting as its tax base net income as returned to and ascertained by the Federal Government, and then recites the advertisement upon which the name of Governor Martin appeared, and the Budget Message of Governor Duff (pp. 3, 4). These observations are not pertinent, because:

(a) The Executive Branch of the State Government is separate and distinct from the Legislative Branch, and alone does not constitute "Pennsylvania" or "The Commonwealth". Consequently, executive opinions expressed in 1946 or 1947 are not determina-

[2] Commonwealth's Brief, pp. 9-11.

tive of legislative intent in 1943, the year when the Act here being construed was reenacted.[3]

(b) The advertisement of June, 1946 was patently inadmissible as evidence, and should not have been considered by the court below or this Court until a ruling as to its relevancy and competency as evidence had first been made.[4] There was no evidence to connect the advertisement with the authorization of Governor Martin.

(c) The Budget Message of Governor Duff was never introduced into evidence, and was not even an issue at the trial of this case. At most, it merely affirmed the existence of an administrative practice, and in no way indicated what the Legislature intended.

(d) The aforesaid conclusions created an estoppel against the Commonwealth by basing the construction of the Act of 1943 on alleged gubernatorial opinions and fiscal practices which arose after the enactment of the statute.[5] Such an estoppel is contrary to the rule laid down by Mr. Chief Justice Stern in *Commonwealth v. Western Maryland Ry. Co.*, 377 Pa. 312, 105 A. (2d) 336 (1954).

4. The Majority Opinion misinterpreted the Commonwealth's contention when it states (p. 5):

> "The Act of 1943, as reenacted in 1945, being a tax act and not an act providing, as the Commonwealth contends, for exemptions or deduc-

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[3] Commonwealth's Reply Brief, p. 30.
[4] Commonwealth's Brief, pp. 87, 88, 91, 97.
[5] Commonwealth's Brief, pp. 36, 37, 117-120. Commonwealth's Reply Brief, pp. 29-31.

tions, must be strictly construed against the Commonwealth * * * ''

On the contrary, the Commonwealth contends that the Act of 1943 did *not* provide for any loss carry-back deduction;[6] that claims for deductions must be construed strictly against the taxpayer;[7] that the burden is on the taxpayer to show where or how the Act of 1943 permitted the loss carry-back deduction. For this reason, the Majority Opinions errs in using the rule of strict construction against the Commonwealth as to this particular deduction.[8]

5. There has been no jurisdiction over the subject matter of this case from the beginning, if the distinction drawn by the Majority Opinion between the instant cases and the case of *Commonwealth v. Chambersburg Engineering Co.*, 287 Pa. 54, is valid:

(a) As interpreted by the Majority Opinion, the reenactment of 1943 must have included the loss carry-back deduction in the definition of net income, because it referred to net income ''ascertained'' by the Federal Government; otherwise, the 1943 reenactment would be the same as the Act of 1923, and the Chambersburg Engineering Company case would control and exclude the carry-back of losses from the 1943 Act.

(b) If the interpretation in (a) is correct, each appellee could have reported a 1942 or 1943 loss on its 1944 net income tax returns and re-

[6] Commonwealth's Brief, pp. 7, 16.
[7] Commonwealth's Brief, pp. 21, 22.
[8] Cf. Commonwealth's Brief, p. 122.

ceived a deduction for them; but neither appellees could return to the Federal Government any 1946 loss in 1944, because no one could imagine whether such a loss would take place.[9]

(c) The Report of Change provision of the 1943 reenactment permitted the filing of the reports of change in net income "returned" only, not in net income "returned" and "ascertained".[10] The 1946 losses were not "returned" to the Federal Government for 1944. Therefore, neither appellee in the instant case had any right to file a Report of Change of net income "returned" to the Federal Government for 1944 (except for "fraud, evasion or error").

(d) The fiscal officers of the Commonwealth had no power or authority to accept, resettle or review any portion of a Report of Change which embodied the carry-back of a 1946 loss, and clearly refused to do so in the instant case.[11]

(e) The lack of right in the taxpayers and the lack of power in the fiscal officers rendered the entire proceedings in the present cases void and lacking in jurisdiction in the court below or this Court.

6. The Majority Opinion (p. 5) incorrectly concluded that, under its interpretation of the reenactments of 1943 and 1945, the Uniformity Clause of the Constitution of Pennsylvania would not be violated.

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[9] Commonwealth's Reply Brief, p. 23.

[10] Commonwealth's Brief, pp. 12-14, Com.'s Reply Brief, p. 22.

[11] Westinghouse 79a-81a; Budd 71a.

On the contrary, since the Pennsylvania tax is an excise tax for an annual privilege, the charge for the privilege would be different for those corporations which in subsequent years had losses which bore no relation to the income for the year for which the privilege is taxed. As to the Westinghouse Corporation, the reduction of tax resulting from the Majority Opinion, when compared with the tax base (each dollar of net income received during the calendar year) reduces the tax rate from 4% to 1.3%.[12] In the case of The Budd Company, the result will be to reduce the rate of tax from 4% to 144/10,000 of 1%. Such a disparity between 4%, 1.3% and .0144% illustrates how the interpretation of the reenactments of 1943 and 1945 by the Majority Opinion violates Article IX, Section 1 of the Constitution of Pennsylvania and the Equal Protection Clause of the Fourteenth Amendment of the Constitution of the United States.

7. The Majority Opinion (p. 5) in referring to the reliance by the taxpayers on the Commonwealth's advertisements and its administrative practices of allowing deductions for operating loss carry-backs must of necessity depend upon evidence which is inadmissible,[13] and which has no probative value.[14] In spite of efforts by the Commonwealth's counsel to have rulings made as to the admissibility and effect of this evidence, both the court below and this Court have failed to make such rulings. The record does not show any reliance worthy of consideration by this

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[12] Commonwealth's Brief, pp. 41, 42.

[13] Commonwealth's Brief, pp. 87-100.

[14] Commonwealth's Brief, pp. 101-108; Comm's. Reply Brief, p. 27.

Court. The evidence does not show that the Act of 1947 constituted, as characterized by the Majority Opinion (p. 6) "an obvious breach of faith by the Commonwealth and * * * very unfair and unjust to the public and the stockholders who bought stocks or bonds of the taxpayers * * * ". The only injustice to the public in the present case stems from the result of the Majority Opinion in requiring the fiscal officers of Pennsylvania to turn over to the appellees a "copious windfall" as a refund of most of the correctly-computed price paid willingly by the appellees for the privilege of doing business in Pennsylvania in 1944. Moreover, there is no evidence whatsoever of any injury to the public, the stockholders or the bond holders of the appellees, and if any such injury were observable, it would be entirely irrelevant in this suit between the Commonwealth and these taxpayers, which are separate corporate entities. Appellees' reliance, if any, was upon the Federal deduction almost exclusively.[15] The omission of the anticipated Pennsylvania carry-back refund would have reduced the value of the Westinghouse shares by only 5¢ per share.[16] If the Westinghouse corporation paid Federal income taxes on the amount of this refund, the amount per share would have been reduced to 2½¢.

8. The Majority Opinion misconstrued the holding in *Welch v. Henry,* 305 U. S. 134, in deciding (p. 8) that "a tax may not be retroactively applied beyond the year of the general legislative session *immediately preceding that of its enactment.*" While *Welch v.*

[15] Commonwealth's Brief, p. 105.
[16] Commonwealth's Brief, p. 108.

Henry upheld a 1935 Wisconsin statute which imposed a tax on income which had been exempt in 1933, it did not fix a rigid limit of retroactivity, as suggested in the Majority Opinion. Even if Welch v. Henry should prevent the 1947 Act from being effective beyond 1945, it must be remembered that the Act of 1947 here being construed operates directly and expressly on the year 1946, which is well within any permissible limit of retroactivity.[17] Moreover, the rule in Welch v. Henry applies to the retroactive imposition of a tax, whereas the reenactment of 1947 neither imposed a tax or increased the rate of the tax applicable to 1944. By its very terms, the 1947 reenactment merely removed possibility of a refund based on a deduction, which is vastly different from the situation in Welch v. Henry. The retroactive elimination of a deduction has uniformly been held to be constitutional.[18]

9. The Majority Opinion (p. 10) incorrectly construed the reenactment of 1947 as being prospective in effect, i.e., applicable only to settlements made after May 14, 1947. The amendment contains no such language, and the presumption of its constitutionality should offset the contrary effect imputed to the effective date clause of the reenactment. The amendment expressly provides "nor shall net operating loss sustained by the corporation during the calendar year 1946 * * * be allowed as a deduction for any prior calendar * * * ". This language applies to *every net operating loss sustained in* 1946. It does not, as inter-

[17] Commonwealth's Brief, pp. 76-87.
[18] Commonwealth's Brief, pp. 66-73.

preted by the Majority Opinion, limit its effect to net operating losses sustained in 1946 and settled after May 14, 1947.[19] If the 1947 amendment were prospective in effect, it could scarcely be deemed to have been unconstitutional for being retroactive.[20]

10. The Majority Opinion, in holding that the reenactment of 1947 violated uniformity and equal protection, should have given greater consideration to the following factors:

(a) The discrimination, if any, between continuing corporations and companies which merged, consolidated, dissolved or withdrew was the result of the failure of the taxing officers to obey the mandate of the Act of 1947 and resettle the settlements made in 1946, as they were authorized to do by the Corporate Net Income Tax Act (72 P.S. §3420h (c)) and the Fiscal Code (72 P.S. §1105).[21]

(b) The discrimination, if any, was de minimis. Data submitted by the Department of Revenue indicates that of the 742 corporations which merged, consolidated, dissolved or withdrew in 1946, 228 showed a net loss for 1946. Of the 228, 225 did not show any carry-back of the loss to prior years. In 15 of these cases the loss from current operations (1946) exceeded the net operating loss deduction reported for prior years, and no adjustments were allowed in 1944 and 1945 settlements for net operating loss in 1946. In the case of 3 corporations a 1946 net loss was carried

[19] Commonwealth's Brief, pp. 113-116.
[20] Commonwealth's Brief, p. 58.
[21] Commonwealth's Brief, p. 114.

back to prior years; Meadville Real Estate Company; Chancellor Hall Corporations and Green Bag Cement Co. of Pennsylvania. The carry-back as to the Green Bag Cement Company was disallowed on resettlement. Therefore out of the 228 corporations which merged, consolidated, dissolved or withdrew during 1946 and showed a net loss for 1946, only two received the benefit of the carry-back of such net loss as a deduction against the income of prior years. The carry-back of these losses resulted in a reduction in tax liability of $277.87 for these two corporations, which sum, when contrasted with the millions of dollars involved in these appeals, is not a substantial basis for lack of uniformity or equal protection.[22]

(c) Even if the reenactment of 1947 is construed as an attempt by the Legislature to classify separately from continuing corporations those corporations which are in the process of terminating their corporate existence in Pennsylvania, the Legislature could make such a reasonable classification.[23]

11. One effect of the Majority Opinion is to overrule *Commonwealth v. Western Maryland Railway Co.*, 377 Pa. 312, and *Federal Deposit Insurance Corp. v. Board of Finance and Revenue*, 368 Pa. 463, because the Majority Opinion permits the reenactments

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[22] "* * * the test of uniformity is, therefore, not whether one or two armored car operators have managed to escape tax liability, but whether the settlements made against the numerous other carriers subject to this act are in substantial accord with the settlement against appellant. * * *": *Commonwealth v. Brinks, Inc.*, 346 Pa. 296, 303.

[23] Commonwealth's Brief, p. 131.

of 1943 and 1947 to be construed in accordance with practices of the fiscal officers and alleged and uncorroborated statements of two Governors; and these alleged opinions are now being used to estop the Commonwealth from asserting that the Legislature did not intend to permit the loss carry-back deduction.

12. The effect of the Majority Opinion is to overrule *Commonwealth v. Quaker City Cab Company*, 287 Pa. 161, and *Commonwealth v. Brinks, Inc.*, 346 Pa. 296, in holding that the administrative failure to rescind the allowance of loss carry-backs in two isolated settlements for part of 1946 rendered the 1947 reenactment unconstitutional for lack of uniformity and equal protection.[24]

13. The effect of the Majority Opinion is to overrule the annual concept of net income set forth in *Commonwealth v. Chambersburg Engineering Co.*, 287 Pa. 54, on the insubstantial distinction between the definitions of net income in the Act of 1923 and the Act of 1943.[25]

14. The Majority Opinion fails to give proper weight to the fact that the 1947 reenactment complained of by appellees did not increase the 1944 tax paid for the privilege of doing business in that year,[26] but merely eliminated a deduction accruing in 1946;[27] it is a *refund* to which appellees have no vested or constitutional rights.[28]

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[24] Commonwealth's Brief, p. 117.
[25] Commonwealth's Brief, pp. 23-27; Comm.'s Reply Brief, pp. 17-21.
[26] Commonwealth's Brief, p. 15.
[27] Commonwealth's Brief, p. 66.
[28] Commonwealth's Brief, pp. 59-66.

15. It is unfair to the citizens and taxpayers of the Commonwealth of Pennsylvania to require without legislative sanction the refunding in 1954 of approximately $3,000,000 to appellees and certain other corporations of the price which these corporations willingly and lawfully paid in 1945 for the privilege of doing business in Pennsylvania in 1944. These corporations exhausted the privilege for which they paid the *annual* excise tax, properly computed, and are not now equitably entitled to a refund of any portion thereof. The biennium system of State financing is not compatible with the contingencies as to the carry-back of future losses, credits for which will unpredictably diminish income as budgeted during the current biennium.

Accordingly, for reasons advanced in the foregoing Petition, in the Brief for the Commonwealth and Reply Brief for the Commonwealth, and in the Dissenting Opinion of Mr. Justice Jones, a reargument should be granted to the Commonwealth of Pennsylvania in the above-entitled appeals.

Respectfully submitted,

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1954.

No. 701.

COMMONWEALTH OF PENNSYLVANIA,
Appellant,

v.

THE BUDD COMPANY (FORMERLY EDWARD G. BUDD MANUFACTURING COMPANY),
Appellee.

COMMONWEALTH OF PENNSYLVANIA,
Appellant,

v.

WESTINGHOUSE ELECTRIC CORPORATION,
Appellee.

MOTION TO DISMISS OR AFFIRM.

Appellees move that the present appeals be dismissed or that the final judgments of the Supreme Court of Pennsylvania in the present cases be affirmed, on the grounds that (a) a state may not invoke the Fourteenth Amendment, (b) the federal question used for the basis of this appeal was not timely or properly raised or expressly passed on, (c) the judgments rest on adequate non-federal bases, and (d) none of the federal questions is substantial or important.

STATEMENT.

The Pennsylvania Corporate Net Income Tax Statute in effect from 1935 to 1946, both dates inclusive, imposed an excise tax upon corporations for the privilege of doing business in Pennsylvania, *based upon net income as reported to and ascertained by the federal government* (with certain statutory exceptions immaterial to this litigation). Sec. 2. See Jurisdictional Statement (hereinafter referred to as "Jur. St.") pp. 43-46. The statute provided that, if the federal government changed the corporation's net income as reported on the federal income tax return, the corporation was required within thirty days to file a report of change; and thereupon, the fiscal officers of the Commonwealth are required to make an automatic resettlement of tax based upon the corrected net income determined by the federal government. Sec. 7. See Jur. St., pp. 46-47.

In order to relieve corporations engaged in the war effort from hardship caused by losses which would likely be incurred in converting from wartime to peacetime business, the United States Revenue Act of 1942 provided that net operating losses could be carried back for two years immediately preceding the loss year as an adjustment of net income for the prior year. Budd Record, 73a-76a, 181a-182a; Westinghouse Record, 30a-32a, 266a-267a. This loss carryback adjustment was recognized and applied in numerous cases by the Commonwealth of Pennsylvania up to May 14, 1947. Budd Record, 184a; Westinghouse Record, 269a; Jur. St., pp. 53, 59-60.

On that date the Commonwealth, faced with the common knowledge that substantial post-war losses had been realized by a number of corporations during 1946 and in order to avoid paying refunds due from resulting adjustments of net income for prior years, passed an amending statute which, so far as these cases are concerned, provided (a) that losses sustained in 1946 and subsequent years

should not be taken into consideration in determining net income for years prior to 1946, and (b) that no resettlement of tax for years prior to 1946 should be made after May 14, 1947 because of any readjustment of income due to the carryback of a net operating loss sustained in 1946 or later years. Jur. St., pp. 44, 48.

Both appellees, which had been engaged almost entirely in war production, sustained large net operating losses during the year 1946. In view of the Act of May 14, 1947, the fiscal officers of the Commonwealth refused to follow the federal government's recomputation of their net income for the year 1944, and, accordingly, refused to grant refunds in the nature of credits.

In the litigation below, appellees contended inter alia that this retroactive statute as applied to them violated (1) the Uniformity Clause of Section 1 of Article IX of the Constitution of Pennsylvania; (2) the Equal Protection Clause of Section 1 of the Fourteenth Amendment to the Constitution of the United States; (3) the Due Process and Property Clauses of Sections 9 and 10 of Article I of the Constitution of Pennsylvania; (4) the Due Process Clause, Section 1 of the Fourteenth Amendment to the Constitution of the United States; (5) the Impairment of Contracts Clause of Article I, Section 17 of the Constitution of Pennsylvania; and (6) the Impairment of Contracts Clause, Article I, Section 10 of the Constitution of the United States. Jur. St., p. 55.

The Supreme Court of Pennsylvania (one dissent), affirming a unanimous decision of the Common Pleas Court of Dauphin County, Pennsylvania, upheld the first four contentions of the taxpayers, stating: "We deem it unnecessary to discuss the other contentions made by appellant or appellees". Jur. St., p. 63.

A substantial part of the litigation below had to do with the interpretation of the state statute. Appellant's briefs in the Supreme Court of Pennsylvania stressed the

following points, all of which were rejected by the state court:

(1) The Act of 1943, under which appellees paid the tax in question, did not, when properly construed, give Pennsylvania corporations the carry-back benefits of the federal law;

(2) The amending Act of 1947 was nothing more than a clarification of prior law; and

(3) If the 1947 Act retroactively changed prior law, it was not unconstitutional under either the state or the federal constitution.

Appellant now belatedly contends that the Act of 1943, as construed by the court below, violates the Equal Protection Clause of the Fourteenth Amendment.

QUESTIONS PRESENTED.

1. Can a state invoke the provisions of the Fourteenth Amendment?

2. Was the federal question, upon which this appeal is based, timely or properly raised or expressly passed upon?

3. Does the state court's construction of "net income", as defined in the state act, raise a question only of local law?

4. Was the state court's determination that the amending Act of 1947 is unconstitutional, based upon adequate non-federal grounds?

SUMMARY OF ARGUMENT.

1. The only alleged basis for jurisdiction on this appeal is that the Pennsylvania Act of 1943, under which appellees paid the tax in question, as construed by the state courts, violated the Equal Protection Clause of the Fourteenth Amendment. In effect, the executive branch of the state is complaining because the judicial branch of that state upheld the constitutionality of an act of its own legislative branch. However, a state cannot invoke the protection of the Equal Protection Clause of the Fourteenth Amendment, because it was expressly and clearly intended to protect *persons* from discriminatory treatment *by a state,* and not to protect a state from itself.

2. The said federal point was reserved in the pleadings before the trial court; but it was not set forth in the statement of questions to be argued before the Supreme Court of Pennsylvania, and it was neither briefed nor argued before that court. The argument presented to that court was that the Act of 1943, when properly construed, did not permit a loss carryback, but if the statute did permit such an adjustment of net income, then it violated the Uniformity Clause of Section 1 of Article IX of the Pennsylvania Constitution. The first express mention of the Federal Equal Protection Clause, in connection with the construction of the Act of 1943, before the Supreme Court of Pennsylvania, was upon petition for reargument. The point was not passed upon by that court either in its original opinion or in its per curiam denial of the petition for reargument.

3. The Jurisdictional Statement questions the construction put on the Pennsylvania statute by the Supreme Court of Pennsylvania. Inasmuch as the rights of the federal government are not involved and no taxpayer is complaining, there is no reason for this court to depart

from its general rule that it will abide by the construction placed upon a state statute by the Supreme Court of that state.

4. The litigation below revolved around the taxpayers' contentions, inter alia, that the amending Act of 1947, which attempted to deprive them retroactively of a loss carryback from 1946 to 1944, violated (1) the Uniformity Clause of the Pennsylvania Constitution, (2) the Equal Protection Clause of the federal Constitution, (3) the Due Process and Property Clauses of the Pennsylvania Constitution, (4) the Due Process Clause of the federal Constitution. The Supreme Court decided all four points in favor of the taxpayers. The Commonwealth contends that the state court committed error as to the second and fourth points. However, the first and third points constitute adequate non-federal grounds upon which to rest the state court's decision. While appellant incorporated this contention in the present appeal, the questions so raised should be disposed of as if presented on a petition for certiorari.

ARGUMENT.

1. The Fourteenth Amendment Cannot Be Invoked by The State.

(Appellants' first point. Jur. St., pp. 18-24.)

The only alleged basis for jurisdiction on this appeal is that the Act of 1943, under which appellees paid the tax in question, was given a construction that makes it violate the Equal Protection Clause of the Fourteenth Amendment on the ground that it gave corporations having net operating loss adjustments a benefit that was not enjoyed by corporations not having such losses. Stated another way, the State is not only attempting to invoke the Fourteenth Amendment for its own benefit, but the ground is that certain corporations, which are not parties to these actions and which have not complained, are discriminated against.

Insofar as the non-complaining corporations are concerned, the Commonwealth has no standing to appeal under the principle that a litigant cannot raise a constitutional point on appeal unless he is harmed by the lower court's decision. *Jeffrey Mfg. Co. v. Blagg*, 235 U. S. 571, 576 (1915); *Knowles Estate*, 295 Pa. 571, 580-587 (1929). Compare *State of Florida v. Mellon*, 273 U. S. 12, 18 (1927), where the federal estate tax credit for inheritance taxes paid to states was challenged by Florida for lack of uniformity under Article I, Section 8, Clause 1 of the federal Constitution relating to excise taxes, and this Court held that such a suit cannot be maintained by a state because of alleged injury to its citizens.

Insofar as the Commonwealth's revenues are concerned, the appellant likewise has no standing to invoke the protection of the Fourteenth Amendment under the equal protection clause. That provision was enacted to protect persons within its jurisdiction from discriminatory treat-

ment *by a state,* not to protect a state from the acts of its own legislature and judiciary. The express language is:

> ". . . nor shall any state . . . deny to any person within its jurisdiction the equal protection of the laws".

This language clearly was not intended to protect a state against acts of the state. It protects persons only, a term which does not embrace states.

In *Columbus & G. Ry. Co. v. Miller,* 283 U. S. 96 (1931), a state tax collector attacked the validity of the Mississippi Tax Amendment of 1926, under which the railroad paid its tax. He had brought suit to collect a larger tax under the prior law. The Supreme Court of Mississippi held that the amending statute created an improper classification under the Equal Protection Clause of the Fourteenth Amendment. The decision of the state court was reversed by this Court on an Appeal and Certiorari. Chief Justice Hughes, speaking for the court said at pages 99-100:

> "We are not concerned with any question of the state's policy in imposing taxes, or with the various methods employed in the levee district, apart from the application of the Fourteenth Amendment. The question as to the validity of the Act of 1926 is raised only by the State Tax Collector in his official capacity, as one acting solely under the authority of the legislature whose requirement he contests. The only person taxed by the statute whose rights are before the Court is the petitioner, which seeks to uphold the state legislation which defines its liability and with which it has complied. The questions which the Collector sought to raise under the state constitution have not been passed upon by the state court. While, so far as state practice is concerned, the authority of a public officer to assail in the courts of the State the constitutional validity of a state statute is a local question, this fact does not alter the fundamental principle, governing the

determination of the federal question by this Court, that the protection of the Fourteenth Amendment against state action is only for the benefit of those who are injured through the invasions of personal or property rights or through the discriminations which the Amendment forbids. The constitutional guaranty does not extend to the mere interest of an official, as such, who has not been deprived of his property without due process of law or denied the equal protection of the laws."

Likewise, in *Scott v. Frazier*, 258 Fed. 669 (D. C., N. D., 1919) the district court stated that it had no jurisdiction to entertain a suit brought by taxpayers "on behalf of the state" to protect it from an alleged unconstitutional use of its own funds. The court said (p. 671):

"This theory presupposes that the state has rights that are protected by the Fourteenth Amendment. If it has no such rights, plaintiffs have no standing in this court as its representatives and must stand on their own feet. Has the state, then, any rights under the Fourteenth Amendment? That question must be answered in the negative. The amendment protects only the rights of 'persons'. This term has been enlarged by judicial interpretation so as to cover private corporations. It does not embrace public corporations, much less the state. Its language is:

> 'Nor shall any state deprive any person of life, liberty, or property, without due process of law, nor deny to any person within its jurisdiction the equal protection of the laws.'

It would be a perversion of language to say this language protects the state against acts of the state. It protects persons only, a term which embraces private corporations, but not public corporations or states. It follows, therefore, that plaintiffs, while they

assert rights under the Fourteenth Amendment, cannot assert rights of the state because it has no rights that are protected by that amendment."[1]

See also:

Newark v. N. J., 262 U. S. 192 (1923);
Williams v. Mayor, 289 U. S. 36, 40 (1933).

None of the cases cited by appellant in the Jurisdictional Statement (pp. 23-24) involved the Fourteenth Amendment. *Indiana Dept. etc. v. Nebeker*, 116 N. E. 2d 104, involved the commerce clause, and *Wilson v. Cook*, 327 U. S. 474 involved the supremacy clause. *Clearfield Bituminous Coal Co. v. Thomas*, 336 Pa. 572, the decision chiefly relied upon, and the cases therein cited, involved only a "local question" under state law.

2. The Federal Question, Upon Which This Appeal Is Based, Was Not Timely or Properly Presented to the Supreme Court of Pennsylvania, or Expressly Passed Upon.

(Appellant's first point. Jur. St., 18-24.)

As stated, the basis of this appeal is that the Pennsylvania Act of 1943, as construed by the state courts, violated the equal protection clause of the Fourteenth Amendment.

While this question was reserved by appellant in pleadings before the trial court, as recited in the Jurisdictional Statement (pp. 11-15), the point was not argued or briefed by appellant in the Supreme Court of Pennsylvania, and

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(1) The District Court also held that it had no jurisdiction because there was no showing that the loss or injury to any complainant amounted to the sum of $3000. The court went on, however, to consider the facts and dismissed the bill on the merits to prevent delay and to permit the suit to be appealed by a single appeal. This Court held that the latter procedure was improper and that the bill should have been dismissed for lack of the jurisdictional amount. *Scott et al. v. Frazier, et al.*, 253 U. S. 243 (1949).

was mentioned before that court for the first time in its Petition for Reargument (Jur. St., pp. 80-81, § 6).

Under the procedure in Pennsylvania, the appellant's statement of questions involved in its brief has taken the place of the assignments of error previously required on appeal. The statement must set forth each question separately and "ordinarily no point will be considered which is not thus set forth or necessarily suggested by the statement of questions involved". *Pa. Sup. Ct. Rule 35.* Appellant's only stated question relating to the Act of 1943, as construed by the lower court, reads as follows:

> "1. Before the 1947 reenactment and amendment was passed, did the Corporate Net Income Tax Act allow the carryback deduction of a net operating loss which was sustained during a year subsequent to the year for which the tax had been imposed?" Budd brief, p. 1; and see Westinghouse brief, p. 1.

In its argument before the Supreme Court of Pennsylvania, appellant discussed the constitutional phase of this question solely under the Uniformity Clause of Article IX, Section 1 of the Pennsylvania Constitution. Not once was the Equal Protection Clause of the federal Constitution mentioned on this question in appellant's brief (see Westinghouse brief,[2] pp. 39-48). In that brief, appellant summarized its argument as follows:

> "The present case involves a tax assessed for the calendar year 1944 at the rate of 4%. The constitutional requirements of uniformity are satisfied by such a tax. However, as soon as a select group of taxpayers are given the privilege of reducing the amount of tax, not by a reduction in net income for 1944, but by a loss in some other year, the reduction in tax becomes in effect the reduction in the rate thereof for the year

(2) The Commonwealth merely filed a summary brief in the Supreme Court of Pennsylvania in the *Budd* case, but incorporated by reference the brief in the *Westinghouse* case.

1944. Thus, the practice of the State taxing departments in permitting the carry-forward or carry-back of net operating losses prior to the enactment of the Act of 1947 was unconstitutional and void, and in conflict with the uniformity requirements of Article IX, Section 1 of the Pennsylvania Constitution." (pp. 42-43)

• • •

"Therefore, any provisions in the Corporate Net Income Tax Act permitting the deduction of net operating losses incurred during years other than the year being taxed would be patently unconstitutional under the Uniformity Clause of the Pennsylvania Constitution." (pp. 44-45)

Appellant admits that the majority opinion of the Pennsylvania Supreme Court did not discuss the federal constitution on this particular point. Jur. St., p. 14.

It was not alluded to in the majority opinion even among the "further" contentions discussed. Jur. St., p. 63; nor by Justice Jones in his dissenting opinion. Jur. St. pp. 64-75.

Appellant attempts to inject this issue into the proceedings before the Supreme Court of Pennsylvania by reference to a statement in its brief and in the majority opinion that for some purposes the Uniformity Clause of the Pennsylvania Constitution and the Equal Protection Clause of the Fourteenth Amendment stand in *pari materia.* Jur. St., pp. 13-14. However, these statements were made in discussion of an entirely different point, properly brought before the court by appellees, namely, that the retroactive amendment of 1947 (not the prior statute) deprived appellees of the equal protection of the laws and violated uniformity.

From this, it is apparent that the federal point now relied upon as the basis for this appeal, although feebly raised in the Dauphin County Court, was abandoned by ap-

pellant on its appeal to the Supreme Court of Pennsylvania and was not expressly passed upon.

This Court has clearly held that a federal question first presented to the state court by a petition for rehearing which was overruled without more, is not a basis for review in this Court.

Mergenthaler Linotype Co. v. Davis, 251 U. S. 256, 258-9 (1919);

Godchaux Co. v. Estopinal, 251 U. S. 179, 180-181 (1919);

American Surety Co. v. Baldwin, 287 U. S. 156, 162-164 (1932);

Cf. *Dorrance et al. v. Pennsylvania,* 287 U. S. 660-661 (1932), and subsequent proceedings recorded in 172 Atl. 900 (not reported in Pa. Reporter) and in 288 U. S. 617 (1933).

Appellant's argument on the merits is patently fallacious.

Appellant argues that, because many corporations did not suffer net operating losses, the allowances thereof by the statute to those which did, grants them a lower *rate* of taxation. But the same argument could be advanced with respect to all other allowable deductions. It might as well be argued that inheritance taxes are unjust because more deductions are allowed in one case than in another. Such deduction is not invalidated merely because it is projected back upon the occurrence of a subsequent event. Thus, in this very case, the Budd Company's 1944 net income was adjusted without question by the Pennsylvania Department of Revenue, upon report of change, because of subsequent accelerated amortization of defense facilities, renegotiation, and renegotiation rebate, in accordance with established practice. See Jur. St., p. 8.

The courts of Pennsylvania have rejected such arguments *under the Uniformity Clause of the Pennsylvania Constitution,* on the sound analysis that a differential

amount of tax does not imply a different *rate* of tax. In this case, the Supreme Court of Pennsylvania said (Jur. St., p. 63):

> "The Commonwealth's further contention that the Acts of 1943 and of 1945 as thus interpreted violate the Uniformity Clause, Article IX, § 1 of the Constitution of Pennsylvania is without merit—the rate of tax is the same and the tax base is the same for every corporation of the same class, and therefore there is no lack of uniformity: *Commonwealth v. Warner Bros. Theatres, Inc.*, 345 Pa. *supra; Turco Paint & Varnish Co. v. Kalodner*, 320 Pa. 421, 184 A. 37."

Replying to a similar argument made in *Turco Paint & Varnish Co. v. Kalodner*, 320 Pa. 421, 426, 184 Atl. 37, 40 (1936), the Supreme Court of Pennsylvania said:

> ". . . It certainly should be axiomatic that the same impost when applied to the same subject-matter does not make the tax graded simply because of the fact that one association, owning more of the particular taxable subject-matter than another, pays, on this account, a greater sum total of the tax . . ."

Likewise, under the equal protection clause of the Federal constitution, this Court has held that a state may tax corporate bonds at nominal value and other personal property at actual value, and "may allow deductions for indebtedness or not allow them", *Bells Gap R'd Co. v. Pennsylvania*, 134 U. S. 232, 237 (1890); in taxing the income of a non-resident, may limit the deduction of losses to those sustained in the State, although residents are permitted to deduct all losses, wherever incurred, *Shaffer v. Carter*, 252 U. S. 37, 56, 57 (1920); *Travis v. Yale & T. Mfg. Co.*, 252 U. S. 60, 75, 76 (1920); and in computing the inheritance tax collectible from a non-resident decedent's property within the State, may apply the pertinent rates to the whole estate wherever located, and take the proportion

thereof which the property within the State bears to the total, even if a greater tax may result than would be assessed on an equal amount of property if owned by a resident, *Maxwell v. Bugbee,* 250 U. S. 525 (1919).

In *Schuylkill Trust Co. v. Penna.,* 302 U. S. 506 (1938), involving the Pennsylvania tax on shares of banks and trust companies, this court said at page 514:

> "And the principle of equal protection does not demand that because one company owns wholly exempt securities, with consequent exemption of its shareholders from the exaction, the state shall abstain from taxing the shareholders of another company whose investments carry no such exemption."

None of the cases cited by Appellant on unreasonable classification, Jur. St., pp. 20-22, have any application to the *facts* of the present cases.

3. The Definition of "Net Income" in the Pennsylvania Statute Is a Matter of Local Law.

(Appellant's second point. Jur. St., pp. 24-31.)

(a) *This involves only a construction of state law.*

Appellant argues that the net operating loss deduction is not an adjustment of net income under the federal law and, since the state courts held otherwise in construing the meaning of "net income" as defined in the Pennsylvania statute prior to 1947, this alleged misunderstanding of the federal tax in some manner, not clearly explained, raises a federal question. However, the Federal income tax is not directly involved and the right of the Federal government to collect its tax is not affected. The only issue was the amount of the Pennsylvania tax.

Despite appellant's protestations to the contrary, the sole question thus presented is whether the Supreme Court of Pennsylvania correctly interpreted the express defini-

tion of "net income" *in the Pennsylvania statute,* which is "net income for the calendar year or fiscal year as returned to and ascertained by the federal government". Suppose, for the sake of argument, that the state court did misunderstand the Internal Revenue Code in this respect. Nevertheless, it was only fixing the meaning of the words in the state statute for purposes of state taxation. As the Supreme Court of Pennsylvania said in *Com. v. Curtis Publishing Co.,* 363 Pa. 299, 309, 69 A. 2d 375 (1949); Cert. denied 339 U. S. 928 (1950):

> ". . . By adopting this mode of ascertaining the tax to be imposed Pennsylvania did not delegate to the Federal government any of the State's power to tax. The act of taxing is the act of the Commonwealth of Pennsylvania. See *Commonwealth v. Warner Bros. Theatres, Inc.,* 345 Pa. 270, 27 A. 2d 62 (1942)."

Miller's Executors v. Swann, 150 U. S. 132 (1893), presented a dispute over title to land, which had originally been granted by Congress to the state of Alabama, which in turn by statute conveyed to a railroad company with right to sell "in accordance with the acts of Congress granting the same". Plaintiff in error claimed under a sale from the railroad and the defense was that the railroad in selling had not complied with the Act of Congress. This Court held that no federal question was involved, saying at pp. 136-137:

> "The question is not what rights passed to the State under the acts of Congress, but what authority the railroad company had under the statute of the State. The construction of such a statute is a matter for the state court, and its determination thereof is binding on this court. The fact that the state statute and the mortgage refer to certain acts of Congress as prescribing the rule and measure of the rights granted by the State, does not make the determination of such

rights a Federal question. A State may prescribe the procedure in the Federal courts as the rule of practice in its own tribunals; it may authorize the disposal of its own lands in accordance with the provisions for the sale of the public lands of the United States; and in such cases an examination may be necessary of the acts of Congress, the rules of the Federal courts, and the practices of the Land Department, and yet the questions for decision would not be of a Federal character. The inquiry along Federal lines is only incidental to a determination of the local question of what the State has required and prescribed. The matter decided is one of state rule and practice. The facts by which that state rule and practice are determined may be of a Federal origin."

Since the state court's interpretation of "net income" in this case does not affect in any way the administration of the federal taxing act, the rule applies that this Court will not interfere in the state court's interpretation of a local statute.

Chicago, Milwaukee, St. Paul & Pacific Railroad Co. v. Risty, 276 U. S. 567, 570 (1928);
Quong Ham Wah Co. v. Industrial Commission, 255 U. S. 445, 448 (1921).

Appellant claims that the Pennsylvania Supreme Court's construction of the Pennsylvania Act was in conflict with its earlier decision in *Com. v. Chambersburg Engineering Co.*, 287 Pa. 54, 134 A. 408 (1926). Jur. St., p. 24. Obviously, this is of no concern to this Court under the above rule. (Incidentally, this claim is erroneous for the reason, pointed out by the Supreme Court of Pennsylvania in its decision, Jur. St., p. 62, that the two cases involved the construction of two differently worded statutes.)

The federal cases cited on this point in the Jurisdictional Statement (pp. 24-30) are not in point. They in-

volved either the protection of rights of the federal government and its instrumentalities, as in *Standard Oil Company of California v. Johnson,* 316 U. S. 481, or the protection of a taxpayer from the state, as in *Crew-Levick Company v. Pennsylvania,* 245 U. S. 292.

(b) *Appellant's argument that the Federal loss carry-back is not an adjustment of the prior year's net income is clearly erroneous.*

The relevant sections of the U. S. Internal Revenue Code of 1939 as amended, are as follows:

"Sec. 21. Net income.

(a) Definition—'Net Income' means the gross income computed under section 22, less the deductions allowed by section 23.

Sec. 22. Gross Income.

(a) General Definition—'Gross Income' includes gains, profits, and income . . .

Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions: . . .

(s) Net Operating Loss Deduction—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122."

It is clear from the quoted sections of the Internal Revenue Code that each appellant's loss carryback from 1946 is a federal statutory deduction allowed in computing its net income for 1944; and does not merely involve abatement of tax.

This point was carefully and clearly analyzed by the Supreme Court of Pennsylvania in *Fischer & Porter Company v. Porter,* 364 Pa. 495, 72 A. 2d 98 (1950).

The case chiefly relied upon by appellant (Jur. St., pp. 27-29), *Manning v. Seeley Tube & Box Company,* 338

U. S. 561, involved an entirely different question relating to interest refunds. The express statutory provision as to interest, contained in Section 3771(e) of the Internal Revenue Code, has no bearing on the *nature* of a loss carry-back adjustment.

4. The State Court's Determination That the Amending Act of 1947 Is Unconstitutional, Was Based Upon Adequate Non-federal Grounds.

(Appellant's third and fourth points. Jur. St., 31-41.)

Appellant's remaining points could be raised independently only by petition for certiorari and should be considered as presented in that form.

(a) *The Court below held that the Act of 1947 violated the Uniformity Clause of the Pennsylvania Constitution.*

As construed by the state court, the Act of May 14, 1947 changed the tax law and retroactively imposed an additional excise tax for the year 1944 upon appellees and other corporations which had sustained net operating losses for the year 1946; but did not impose such additional tax upon corporations similarly situated which had succeeded in obtaining a resettlement of tax for the year 1944 prior to May 14, 1947. The court said (Jur. St., pp. 59-60):

> "The Act of 1947 means, and it was so interpreted by the fiscal and administrative officers of the Commonwealth, as the Chancellor found, based upon adequate evidence, that in case corporations sustained net operating losses in 1946 and because of going out of business or because of a merger or consolidation or a withdrawal from the State or for any other reason, obtained from the Commonwealth a resettlement of its taxes prior to May 14, 1947, that resettlement, with its deduction for a carry-back loss sustained in 1946, was valid; but other corporations of the same class, with net oper-

ating losses sustained in 1946, were not entitled to a deduction therefor if no resettlement had been made prior to May 14, 1947. In other words, corporations of the same class, each having net operating losses in 1946, are treated radically differently, *depending solely upon the date of resettlement.* The liability or nonliability for (a higher) tax was made to depend, not upon the amount of net income as ascertained by the Federal Government, not upon a corporation's net operating loss in 1946, not upon a justifiable classification of corporations, but solely upon whether a resettlement of carry-back losses for 1946 and prior years was made by the fiscal or administrative officers of the Commonwealth prior or subsequent to May 14, 1947. Such a classification, such a tax, is arbitrary and unreasonably discriminatory; the tax is not applied with substantial equality of the tax burden to all members of the same class. The effect of the Act is to produce arbitrary, unjust and unreasonably discriminatory results and, for these reasons, it violates, so far as these taxpayers are concerned, Article IX, § 1 of the Pennsylvania Constitution and § 1 of the Fourteenth Amendment of the Constitution of the United States."

The state court held that the Act of 1947, so construed, violated the Uniformity Clause of Section 1 of Article IX of the state Constitution, the material part of which reads as follows:

> "Sec. 1. Uniformity of Taxation—Exemptions—Rebates. All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax, and shall be levied and collected under general laws; . . .".

While the state Supreme Court also held that the statute violated the Equal Protection Clause of Section 1 of the Fourteenth Amendment to the Constitution of the

United States (and said that the state and federal limitations as applied to questions of taxation "stand in pari materia"[3]), nevertheless its decision (insofar as it applied to the Uniformity Clause in the state Constitution) was rested primarily upon Pennsylvania court decisions (Jur. St., pp. 57-58): *Allentown School District Mercantile Tax Case,* 370 Pa. 161, 87 A. 2d 480 (1952); *Com. v. Girard Life Ins. Co.,* 305 Pa. 558, 158 A. 262; *Knisely v. Cotterel,* 196 Pa. 614, 46 A. 861 (1900); *Dufour v. Maize,* 358 Pa. 309, 56 A. 2d 675 (1948); *Com. v. McCarthy,* 332 Pa. 465, 3 A. 2d 267 (1938); *Dole v. Philadelphia,* 337 Pa. 375, 11 A. 2d 163 (1940); *Turco Paint & Varnish Co. v. Kalodner,* 320 Pa. 421, 184 A. 37 (1936); *Com. v. Overholt & Co., Inc.,* 331 Pa. 182, 190-91, 200 A. 849 (1938).

This Court will not review a state decision which rests upon adequate state grounds.

> *Murdock v. City of Memphis,* 20 Wall. 590, 635 (1874);
> *Flournoy v. Weiner,* 321 U. S. 253, 261 (1944);
> *Herb v. Pitcairn,* 324 U. S. 117, 125-6 (1945);
> *Fox Film Corp. v. Muller,* 296 U. S. 207 (1935).

It is clear that the state court's first reason for declaring the Act of 1947 unconstitutional, namely, the holding that it was discriminatory and involved unfair classification of taxpayers in violation of the Uniformity Clause of Section 1 of the Constitution of Pennsylvania, was primarily *factual.* The state court did not attempt to lay down any new rules concerning classification or discrimina-

(3) This statement is open to question. Unlike the state constitution, the Fourteenth Amendment does not require uniformity of taxation. *Swiss Oil Co. v. Shanks,* 273 U. S. 407, 413 (1927). Compare *American Stores Co. v. Boardman,* 46 Pa. Dauphin County Reports 334, 345, 358 (1940), affirmed 336 Pa. 36, where the court held that a graduated state license tax on chain stores, depending on the number of stores, violated the Pennsylvania Uniformity Clause, although similar taxes had been upheld by this Court as not violating the Equal Protection Clause of the federal Constitution.

tion, but only applied well recognized rules to the particular facts of this case. Cases involving the doctrine of equal protection turn primarily on the facts of each particular case, and therefore, the decision of the Pennsylvania state court applying the Uniformity Clause of the Pennsylvania Constitution to a certain set of facts, would not bind the federal courts in applying the federal rule to other factual situations. The issue on this point, therefore, does not present a question of federal law of importance to anyone except the Commonwealth of Pennsylvania, whose courts have decided the issues against the Commonwealth. What the Commonwealth really seeks is simply another hearing on the facts, which this Court will not grant.

Magnum Co. v. Coty, 262 U. S. 159, 163 (1923).

While we believe that the Act of 1947, as construed by the state court, also violates the Equal Protection Clause of the federal Constitution, this does not have to be decided by this court, since the application of the state Constitution to the particular facts of this case does not prejudice the application of the Equal Protection Clause of the federal Constitution to the separate facts of other cases.[1]

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(1) Appellant distorts the legal issue involved by self-serving statements of fact outside the record, that only a few corporations received discriminatory settlements allowing net operating loss carrybacks from 1946 (Jur. St., pp. 39, 40). This averment of fact was first made in the Petition for Reargument (Jur. St., pp. 84-85) and was properly ignored by the Pa. Supreme Court. There is not a scintilla of evidence or any finding of fact in the records in these cases to support appellant's assertion of fact, and appellees do not admit it. On the contrary, as the state court indicates, its findings were "based upon adequate evidence" (Jur. St., p. 59), to wit, the testimony of state witnesses (Westinghouse Record, 167a-177a), and the findings of fact by the state trial court (Westinghouse Record, 269a, 270a; Budd Record, 184a, 185a).

(b) ***The Court below held that the Act of 1947 violated the Protection of Property Clauses of the Pennsylvania Constitution.***

The Supreme Court of Pennsylvania also predicated its decision upon the "additional reason" that the Act of 1947, as applied in these cases to appellees' 1944 corporate net income, denies due process and is void (Jur. St., p. 62). On this point, the state court said earlier in its opinion that "the 1947 Act if retroactively applied to 1944 net income, clearly violates both the federal Constitution and the state Constitution" (Jur. St., p. 56).

The pertinent sections of the state Constitution, both of which are contained in Article I—Declaration of Rights, read as follows:

> "Section 9. • • • nor can he be deprived of his life, liberty or property, unless by the judgment of his peers or the law of the land."
>
> "Section 10. • • • nor shall private property be taken or applied to public use, without authority of law and without just compensation being first made or secured."

While the Pennsylvania court stated that it was "following *Welch v. Henry*", 305 U. S. 134 (1938) and held "that a tax may not be retroactively applied beyond the year of the general legislative session immediately preceding that of its enactment" (Jur. St., p. 62), it does not follow that this court must review that conclusion (which, nevertheless, we believe is correct).

As this court said in *Forsyth v. Hammond*, 166 U. S. 506, 518-519 (1897): "The construction by the courts of a State of its constitution and statutes is, as a general rule, binding on the Federal courts. We may think that the Supreme Court of a State has misconstrued its constitution or its statutes, but we are not at liberty to therefore set aside its judgments."

In *Welch v. Henry,* which according to the Supreme Court of Wisconsin reached "the limit of permissible retroactivity" (305 U. S. 134, 151), a tax imposed in 1935 on 1933 dividends was justified under the "recent transactions" doctrine, particularly since the Legislature acted at its first opportunity. The Pennsylvania statute in the present case could not be justified on that ground, because the Act of 1947 reached back 3½ years and jumped over an intervening session of the state legislature in 1945. Therefore, the conclusion reached by the Pennylvania Supreme Court could not possibly be in conflict with the decision of this court in *Welch v. Henry.*

Moreover, the reasoning of the Supreme Court of Pennsylvania, taken as a whole, indicates clearly that the court would have reached the same result in this case, irrespective of the decision in *Welch v. Henry,* insofar as the state constitutional limitations are concerned. Thus, the state court's opinion says (Jur. St., p. 61):

> "It is obvious, however, that there must be some limitation on the right of a legislative body to pass laws imposing taxes retroactively, for otherwise a legislature could constitutionally impose new or increase taxes retroactively for a period of 25 or 50 years which would be so onerous or confiscatory and unjust as to bankrupt the individuals or corporations thus taxed." (R. 379 Pa. 171.)

The state court's reference to *Welch v. Henry* must not be read out of context, in disregard of the underlying reasoning of the state court that, upon the facts and circumstances of this particular case, the action of the state legislature was unfair and unjust, thereby violating the above quoted provisions of the state Constitution. The court said (Jur. St., p. 55):

> "It would be regrettable if the law required us to sustain the Commonwealth's present contention that the Act of 1943 never permitted any carry-back losses

in the computation of corporate net income and that the 1947 Act should be retroactively applied, because it would constitute *an obvious breach of faith by the Commonwealth* and be very *unfair and unjust* to the public and the stockholders who bought stocks or bonds of the taxpayers (on the faith of important statements which taxpayers properly made in reliance on representations of the Commonwealth's highest officials) as well as to the Securities and Exchange Commission and to each of the taxpayers here involved." (Emphasis supplied.)

It is clear, therefore, that the important point on which the state court reached its decision was not the period of retroactivity involved, but rather *the unreasonableness of the retroactivity under the facts of this particular case.*

The Pennsylvania Supreme Court overruled the contention of the Commonwealth that the Act of 1947 was merely declaratory of the prior law in Pennsylvania. It pointed out that the Governor of the state in his budget message in January 1947 recommended "a change" in the corporate net income tax in order to obtain increased revenue by removing recognition of loss carrybacks (Jur. St., pp. 53-54).[1]

The Pennsylvania Supreme Court also pointed out that the Commonwealth, in order to attract business to come or

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(1) The Supreme Court of Pennsylvania held that the 1947 Act imposed an *additional tax* on appellees for the year 1944 (Jur. St., pp. 60, 61, 62). This constitutes a construction of a state statute by a state court which this court will not review. Accordingly, appellant's argument that the 1947 Act merely removed a deduction theretofore allowed for the year 1944, which was a matter of legislative grace and, therefore, did not violate due process, is beside the point (Jur. St., pp. 31, 32, 36). So also, its argument taken from Justice Jones's dissenting opinion that the 1947 Act struck at the year 1946 and not the year 1944 (Jur. St., pp. 36, 37) does not represent the state court's construction of the statute and is beside the point.

remain in the state, had advertised in leading newspapers on the Atlantic Seaboard that "there are provisions for carryback and carryforward of corporate losses for purposes of State corporate income tax calculations which result in an effective average method of determining taxable income" (Jur. St., p. 53).

The court further found that each of the taxpayers, in reliance upon the prior law and official advertisements and practice, had during the interim "made vital decisions and commitments, and in connection with mergers and a sale of debenture bonds and preferred stock, issued to its stockholders (in connection with possible purchases of stock), and to the buying public and to the (Federal) Securities and Exchange Commission, statements of taxpayer's right to carry back operating losses for the two years in question" (Jur. St., p. 54). The court then concluded on this point (as quoted more fully above) that the conduct of the Commonwealth was arbitrary, unreasonable and an obvious breach of faith; and therefore violated the Pennsylvania constitution.

CONCLUSION.

We respectfully submit, therefore, that (a) a state may not invoke the Fourteenth Amendment, (b) the federal question used for the basis of this appeal was not timely or properly raised or expressly passed on, (c) the judgments rest on adequate non-federal bases, and (d) none of the federal questions is substantial or important; and that the present appeals should be dismissed or the judgments of the Supreme Court of Pennsylvania should be affirmed.

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No. 701. PENNSYLVANIA *v.* BUDD COMPANY ET AL. Appeal from the Supreme Court of Pennsylvania, Middle District. *Per Curiam:* The motion to dismiss is granted and the appeal is dismissed for failure to properly present a federal question. As to questions not subject to review by appeal, the papers whereon the appeal was taken are treated as a petition for writ of certiorari and certiorari is denied for the reason that the judgments rest on adequate state grounds. *Herbert B. Cohen,* Attorney General of Pennsylvania, and *George W. Keitel* and *Howell C. Mette,* Deputy Attorneys General, for appellant. *Henry S. Drinker, Leslie M. Swope* and *James J. Dougherty* for the Budd Company, and *Charles E. Kenworthey* and *Roy J. Keefer* for the Westinghouse Electric Corporation, appellees. Reported below: 379 Pa. 159, 108 A. 2d 563.